# *Speculating On Convergence: The Western European Finance-Led Growth Regime and the New European Periphery*

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I hereby declare that this thesis has not been and will not be, submitted in whole or in part to another University for the award of any other degree.

**Signature**:.............................................

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## Summary

Operating at the theoretical boundary between Political Economy, International Relations and Regional European Integration Studies, this Doctoral thesis explores how the 'top-down' institutional redesign of the expanding European polity has worked to produce the necessary extra-market (social and political) support structures for the rise of European financial capital, while profoundly reshaping the dynamics of accumulation and social reproduction on the European continent. As such, this work links the processes of deepening and widening European integration to the wider sphere of global financial integration and finance-led restructuring, a lacuna in the existing literature.

Concretely, I argued that finance, the preeminent globalising force rather than a tertiary activity, has been at the centre of European integration project. Over the past decade in particular, the transformations in the European financial sector, the so-called financialisation of Europe, while seemingly driven by imperatives arising from the exigencies of economic competition, should be understood primarily as a political-economic process deeply embedded in a geopolitical rivalry. Crucially, Europe's engagement, while embedded in a global financial system, is distinct. European finance proceeds on the basis of its institutional specificity. Here history, tradition, culture, and geopolitical context, and therefore in turn, specifically European institutions, define the mechanisms through which the financialisation of the European space has unfolded.

From this standpoint, the thesis also explores the constitutive role played by Western European financial institutions in the financial integration of the Central European new member states and the consequent ideological and institutional reconfiguration of Europe's Eastern post-communist periphery in line with the demands of a liberal (financialised) market democracy. In doing so, the thesis also poses a challenge to the dominancy of a-historic and depoliticized (indeed teleological) narratives of capitalist state formation in post-communist Central Europe, which ultimately reduces post-communist transformations to a straightforward and technical transition towards a predefined capitalist future.

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# Introduction

This thesis interrogates what is at least potentially one of the singularly most important phenomenon in the global political economy as we emerge into the 21st century; namely, the project to construct an integrated European space as both a competitive economic bulwark and a politically coherent block. The project is of course broad-based, with European policy reaching into almost every aspect of the social constitution of its member states. While, most would conceive of this process as an inherently and predominantly political one, a process that concerns mostly transformation of formal political structures, others portray, and indeed perceive the rise of this European space as essentially an economic project, aimed at achieving the necessary economies of scale to ensure successful insertion in a global economy.

This binary understanding reflects the ingrained supposition of an inherent division between the political and the economic characteristic of modern Western thought in particular; the economists focus on competition, growth and macro-economic policy, while the political analysts' focus rests with issues of authority, legitimacy and internal cohesion. However, the inadequacy, and limitations, of both has been made patently evident by the fact that neither of these perspectives, political or economic, was appropriately armed to apprehend that perhaps the biggest threat to the future of Europe's project lay in fact in some arcane practices in the financial sector.

This research project adopts an altogether different conceptual framework, one which is firmly rooted in the 'European' tradition of critical international political economy, eschewing the very proposition of an intellectual division of labour between the political and the economic. Empirically, this thesis takes as its object of analysis what would be commonly understood as a highly technical and almost entirely economic phenomenon; namely the integration and wholesale restructuring, or transformation, of Europe's financial sectors.

The political process of top-down, finance-led, restructuring of the European polity launched in the late 1990s, and the consequent rapid and dramatic developments of the European financial landscape, represents a radical departure, and stands in stark contrast to the complacent and lethargic pace characteristic of the European financial sector during the second half of the 20th century[1]. This Thesis focuses on this historic shift, and addresses the question of how can we best understand the shifting patterns of accumulation in Europe in relation to global and regional processes of finance-led restructuring? Applied to the empirical role of financial intermediaries in Europe, the question can be further narrowed down through a focus on the factors which best explain the changes in the business models, strategies and behaviour of European financial agents.

Several sub-questions arise from this particular formulation. Firstly, are European market participant responding primarily to pressures and incentives emanating from their domestic, regional-European, or global financial environments? Related to this, is Europe undergoing a process of convergence, or so called 'institutional flattening' towards Anglo-Saxon institutional forms of finance capitalism? Or alternatively, is there an emergent distinct and coherent European variant of financialisation, which is internally consistent and can pose a genuine challenge to Anglo-Saxon forms of financialisation? Finally, what are the implications of the transformations in the European financial landscape for the broader European economy and for the political project of European integration? Are these shifts supporting or undermining the wider socioeconomic goals of European policy elites and European societies?

Finance, the preeminent globalising force, rather than a tertiary activity, the argument suggests, has stood at the core of project of European integration since its re-launch. Within the context of financialised global political economy, the main argument in this thesis is that the transformations within the European financial sector, the so called financialisation of accumulation patterns in Europe, while seemingly driven by imperatives arising from the exigencies of economic competition, should be understood primarily as a political-economic process deeply embedded in a geopolitical rivalry.

[1] The subdued, not to say boring, nature of European finance since World War II has been particularly pronounced when compared to its trans-Atlantic rival.

This rivalry, however, contrary to some accounts, is not as one-sided as might intuitively appear. Europe is not simply mimicking the competitive success of the United States. Neither has Europe simply capitulated, or have been subjugated to global forces emanating from the Washington-Wall Street Nexus. Rather, and crucially, Europe's engagement, while embedded in a global financial system is distinct. The transformation in Europe's financial markets and in the strategies of European financial agents proceeds on the basis of its institutional specificity. Here history, tradition, culture, inheritance and geopolitical context, and therefore in turn specifically European institutions, define the mechanisms through which the financialisation of the European space has advanced.

Thus the unfolding expansion and transformation of financial practices and financial relations in Europe constitutes the focus of analysis. The analysis reveals that the financialisation of the European economic space, while subject to global and European imperatives on the one hand, is also thoroughly embedded in a pre-existing institutional and organisational contexts reaching back as far as the pre-world war I era. Thus, far from a simple convergence towards Anglo-Saxon institutional forms Europe is in fact experiencing a plurality of finance-led transformations, or financialisation experiences.

Furthermore, it is incumbent that at least some of the emerging constellation and institutional configurations have in fact proved remarkably 'complementary' to the exigencies of global finance and thus successful in promoting a burgeoning and globally extensive European financial sector. This is of course somewhat of a mixed blessing, as the current conjuncture of global financial turmoil and instability has left the most financialised of Europe's economies the most vulnerable, while relative laggards have tended to fare better. Meanwhile predatory expansion to the East reveals not only the institutional specificity of the financialisation of a European space, but also the limits of the current mode of expansion.

The thesis is elaborated in five chapters. Chapter One surveys existing accounts of European financial integration and finance-led restructuring. In so doing this chapter highlights the limiting nature of the intellectual division of labour between political and economic analyses, or in other words the separation between states and markets in the conventional problematisation of European financial integration. Even within the field of International Political Economy The contours of the debate about European financial integration and finance-led restructuring have, to a large extent, been defined by the differing appraisals of the relative strength of global financial markets versus national (or regional) institutions.

However, (diverging normative perspectives notwithstanding), this more or less empirical disparity could only be upheld on the basis of a mutual (often implicit) understanding of how markets and institutions are constituted and interact. This chapter takes its cue from the growing number of authors whom in recent years highlighted this tension within International political economy and seeks to advance the debate by focusing on the constitutive role played by state institutions for the proliferation of financial market relations and their increasing permeation of evermore spheres of social life

Chapter Two proceeds by positioning the recently burgeoning and often quite eclectic discourse of financialisation within a broader framework for interpreting processes of historical and epochal change as epitomised by the notion of a finance-led growth regime of accumulation derived from the French Regulation School in IPE. This chapter aims to take some initial steps in overcoming the bifurcation posited in Chapter One, by reflecting on ways in which concrete, micro-level institutional frameworks, techniques and practices of financial market participants are amalgamated in and through financial expansion and innovation.

In doing so, this chapter demonstrate that the global sprawl of financial markets, and the relentless market and financial product innovation which are the hallmarks of the contemporary era of finance capitalism on both sides of the Atlantic cannot be ascribed simply to a process of markets disembedding themselves from their institutional context, but rather that the expansionary tendencies that mark financial markets are themselves produced in and through dense and complex institutional networks.

Deploying the regulationist theoretical frameworks denoted by the concept of 'regime of accumulation', *Chapter Three* addresses the ambivalence inherent to the process of European financial integration; to the extent that the European financial system has in certain respects developed towards a US-like liberal structure, it did so by relying on institutional forms inherited from an age old tradition of state-led capitalism in continental Europe. Thus, here is where the abstract tensions alluded to in previous chapters are empirically articulated in the diverging demands on European integration to achieve a civil-legal European space, in which transnational capital could be liberalised from national subordination to the state, with the creation of a European supranational structure which will allow to 'lock in' German industrial resurgence into a 'European' framework with real regulatory powers.

Consequently, European integration achieved its expanding institutional infrastructure, with France in most cases in the role of the ostensible initiator. Over half a century, this infrastructure, combining supra- or transnational institutions and decision-making arrangements in the economic and monetary field with intergovernmental structures (at most, pooling sovereignty) in the social and foreign policy fields, has resulted in the polycentric, 'hybrid' entity that is the EU of today. However since the end of the Cold War and German reunification The Bonn-Paris axis was dishevelled: the fall of the Berlin Wall heralded a new phase in which the traditional leverage France enjoyed has become unstuck, France would no longer have the ability to forestall a German Alleingang, facilitating the finance-led neoliberal turn of the EU. In this sense we are looking at a historic breaking point for European integration. Arguably, a free space for capital, with separate state jurisdictions keeping political sovereignty and democracy away from the larger structure, leaves only a thin line between European and full-fledged neoliberalism, Anglo-Saxon style

*Chapter 4* examines the outcomes of Europe's politically instigated, top down programme, again from a micro and a macro perspective. Emphasis has been placed on the institutional specificities of the European tradition and experience, while firmly placing these in a trans-Atlantic constellation as a phenomenon, which is both global and necessarily diverse. The chapter provides substantial evidence for Europe's credentials as a financialised rival, and especially as a credit powerhouse for the developing world.

It is clear that the European experience has been marked by both successful interventions in a global financial market place, as well as less successful ones; Institutional complementarity is thus shown to be contingent rather than automatic, and the outcome of developmental trajectories in European finance in no way inexorable, let alone exogenously determined. That European banks have been emboldened by their policy elites to pursue ever more risk seems to have left the European system in a curious bind. On one hand Europe has on many gauges regained a position of ascendancy last seen at the beginning of the last century, while on the other hand Europe was vulnerable to the onset of the systemic crisis and is now in a precarious position as the crisis continues to develop, evolve and unfold.

*Chapter 5* demonstrates the implications of Europe's effort to globalise its financial agenda and reach. Nowhere has this strategy been more pronounced than in central Europe where states, locked into an exogenously defined trajectory by the accession process and the recipients of the largest credit flows from Europe, have become heavily enmeshed in what has been shown to be a distinctively European process of financialisation. The chapter exposes the tension that exists between the official discourse on the benefits of financial liberalisation, and the private interests of financial institutions and groups which were part of the move east.

The chapter puts forward the argument that the actual motivations and strategies of Western European financial expansion were never geared towards addressing the developmental needs of Central European economies in the first place. Rather, they were inherently predatory, aimed at redressing the declining profitability of financial institutions operating in the already financialised economies of Western Europe and geographically diffusing the internal contradictions of European finance-led growth. The dominancy of foreign financiers in the region was a primary catalyst in the reorientation of state policy, corporate strategy and households' practices, in line with the imperatives of financially based accumulation strategies. This has led not only to an unprecedented transfer of property rights from local society to foreign investors, but also to increased indebtedness and vulnerabilities in host societies, which in the context of the current crisis have proven to be unsustainable.

The thesis concludes by remarking on the borderless character of economic processes while emphasizing the historically and institutionally specific nature of their articulation. European financialisation is neither the automatic adjustment to global imperatives nor is it the outcome of an exclusive ‘European’ dynamic. Far from Anglo-Saxon convergence and institutional flattening, nevertheless financialisation does not leave European structures of accumulation and reproduction untouched. Equally, the crisis of financialisation is at once global and particularistic. Whether or not European financialisation will weather the storm, emerge fortified, or fold will invariably depend on events in other parts of the world and given Europe’s position in global credit markets will arguably be at least as important for the global economy as the fortunes of the US.

# Chapter One Different logics of European integration and the unexplored dynamics of finance-led restructuring

While the occurrence of financial integration, and (albeit) to a more limited extent, finance-led restructuring in the EU has been relatively well documented, the interpretation of these trends – what does finance-led restructuring entail and what are its implications? – as well as the explanation of restructuring – why, and how does finance-led restructuring happen? –are still far from settled questions. This set of interrelated questions which guides this research project sits at the intersection between two scholarly debates: firstly, why do European states liberalise and pursue further financial integration and a single financial market? and secondly, which particular institutional configuration, or financing arrangement are most appropriate for the European economies and conducive for growth? Scholars of European Integration and global finance have addressed these two questions respectively and while their answers provide helpful starting points they also leave some key questions unanswered. The limitations of these respective analyses derive primarily from their inability to account for the ontological unity between global (financial) markets and European (socially constructed) institutions.

The review of the literature is organised as follows: section 1.1 introduces the main International Relations theories of European Integration. Neofunctionalism and intergovermentalism represent the first attempts at a systematic and theoretically informed account of European integration and as such have been highly influential both on the praxis or policy process of European integration and on the more contemporary modes of thought and academic investigation of European integration. Section 1.2 moves on to discuss the mainstream economic logic underlying European integration. Specifically the section dwells on the theoretical underpinnings of financial integration and restructuring as they emerge from both the policy discourse and from orthodox finance theory. Arguably the economic logic of integration uncovered in this section stands at odds with both the political logic of state preference as well as the notion of sectoral spillover central to intergovermentalist and neofunctionalist approaches respectively.

Finally section 1.3 focuses on the contours of the debate about European financial integration and finance-led restructuring as it emerges within the discipline of political economy. Concretely the contribution and limitations of three ontologically distinct types of explanations are evaluated. Firstly, Ideational (neo-Gramscian) theories of European integration have been instrumental in shifting the debate from the institutional form to the socio-political content of European integration, but at the same time fall short of theoretically accounting for the role of the financial sector in this process. Secondly, structural approaches emphasize the fundamental shifts in the global economy associated with the re-emergence of global finance (and particularly Anglo-American finance) following the breakdown of the Bretton Woods monetary regime. However, in focusing on these structural changes in the global economy these approaches fail to connect convincingly between observable macro trends such as the explosion of leverage and of transnational flow of finance and the myriad of underlying micro-level practices, strategies and behaviour that constitute the substance of this research.

Thirdly, institutional approaches demonstrate that contrary to widely-held beliefs, institutional specificities and differences continue to matter in an era of economic globalization. However, the prodcutivist bias of the varieties of capitalism literature in particular as well as its conceptualisation of social and political institutions as 'society's tools for re-embedding the expansionist logic of the market' (Konings, 2008: 254)is more appropriate for accounting for continuity rather than change and restructuring. Meanwhile the constitutive role of social institutions in the expansion of evermore variegated forms of credit relations, many of which not directly related to the social relations of production, remains as of yet outside the purview of this literature. It is precisely in this direction that this thesis aims to make a significant contribution to both in advancing the theory of financialisation and finance-led growth and empirically by accounting for the observable micro level transformations in credit relations in Europe.

## 1.1 European Integration as the prerogative of 'the state'

Much of the existing analysis of European Integration more broadly, originated from the disciplines of Political Science and International Relations (IR). IR scholars in particular are responsible for the first major contributions to theorizing the process of European integration evaluated through the lens of 'state action' (Keohane & Hoffman, 1991). Indeed IR as a discipline, has long been interested in questions such as why, and under what conditions, actors (and especially state actors) choose to collaborate, 'pool' their sovereignty, or engage in a delegation of authority (for summaries of the various integration theories see Cini, 2003; Rosamond, 2000; Wiener and Diez, 2004).

By the same token, the different, contending, explanations offered for European integration by IR scholars since the 1950s and to this day also came to closely reflect the prevailing debates between the various competing theoretical schools within the discipline of IR, most notably, realism, functionalism (or in its contemporary guise, neoliberal institutionalism) and constructivism (Fligstein and Mara-Drita, 1996; Verdun, 2005; Schrapf, 1997). In this context European integration is often treated as a case study that supports already well-established theoretical conclusions.

The IR agenda of the post-World War II and early Cold War era was dominated by a theoretical and an empirical focus on issues of War and Peace[2]. It was thus no surprise that much of the early research was particularly concerned with explaining the so-called 'causes of European Integration'. The two most widely cited traditional theories of European integration, neofunctionalism (Haas, 1958; Lindberg, 1963; Mitrany, 1943/1966; Puchala, 1972) and intergovernmentalism (Hoffman, 1966), represented two opposing logics in this debate, the former emphasizing the role of supranational institutions, the latter that of national governments, in instigating and driving integration forward[3]

[2] This is especially true with regard to research originating from the English speaking world.

[3] Another theoretical approach promoted in this period was developed by Karl Deutsch. He emphasised the role and implications of greater transnational communication amongst European elites for the process of integration (Deutsch et al. 1957, 1967). Deutsch's approach did not attract the attention that neofunctionalism and intergovermentalism did, however it has been argued that social constructivism, which gained popularity from the 1980s onwards, in fact follows in the footsteps of Deutsch's approach.

Neofunctionalism saw the process of European Integration as a direct response to functional needs of European states, faced by the need to improve their governance efficiency and capacity to address economic, social and political problems which could best be dealt with at a supranational level (Haas, 1958:297; Lindberg, 1963:294). The concept of spill-over is a key component of the neofunctionalist interpretation of European Integration. Functional spill-overs occur as a result of the interdependence of different industrial sectors, and economic activities. The integration of one sector makes the integration of further industries necessary in order to reap the full welfare benefits of the former (Haas, 1958).

Sectoral spill-over was arguably also augmented by a concomitant process of political spill-over, as lobbying and collective interest representation activities gradually shift from national policy centres to the new decision-making centre in order to maintain and enhance their influence over decisions directly impacting their constituents and to press for further integration of related sectors. Thus, the *'main thesis was that sectoral integration was inherently expansive'* and that therefore '*once transnational co-operation has successfully started in one sector, the logic of spill-over automatically leads to integration in further sectors'* (Tranholm-Mikkelsen, 1991:6).

Neofunctionalism articulated an early attempt to systematically theorise processes of regional integration. It generated many valuable insights into European Integration, many of which have been retained, and indeed informed further efforts to theorise such processes, most notably liberal regime theory and neoliberal institutional analysis. Its analytical purchase has also arguably transcended the empirical specificity of its original case study of European regionalism. However, Neo-functionalism also suffers from several crippling limitations. To start with, the concept of spill-over implies an inevitable, teleological process of further integration along a line of objective economic rationality. As the aptly named period of 'Eurosclerosis' in the 1970s attest to, instances of integration are anything but inevitable. Rather, they are the result of intense political struggle, which could also have resulted in a variety of contingent outcomes as professed by Hass himself (Haas, 1975).

Neofunctionalism's focus on the internal dynamics of European politics, justified as it may be, also serves to discount the wider structure, within which European Integration is taking place. It therefore does not lend itself to adequately accounting for the role and implications of global and structural transformations such as the end of the Cold War, globalisation, or indeed financialisation on the process of European Integration (Bieler and Morton, 2001b; Van Apeldoorn, 2002). Acknowledging these limitations, contemporary neofunctionalists still maintain that the concept of spill-over is a useful analytical tool, albeit only as part of a more diversified, and less deterministic, theoretical toolbox (George, 1996: 275-283; Sandholtz and Stone Sweet, 1998: 1-26). In this vein, Tranholm-Mikkelsen (1991)concluded that a return to the automaticity of the spill-over as an exclusive explanatory mechanism is neither attainable nor desirable (p.18).

In contrast to Haas's neofunctionalism, which emphasised the importance of non-governmental actors, Stanley Hoffmann's (1966) intergovermentalism focused exclusively on the behaviour of inter-state bargaining as the primary determinant in the process of European integration (Garrett and Weingast, 1993). As such, intergovermentalism clearly articulated the dominancy of the realist paradigm within IR during the 1960s and 1970s.

Realism as succinctly summarised by Morgenthau, (1960) considers the anarchic nature of the international system to be the starting point to the analysis of state strategy. Under conditions of anarchy states (as the only agents of significance) are morally and rationally obliged to pursue rationalist policies of power maximisation and security enhancement in order to ensure their survival. As the Anarchic nature of the system, as well as the sovereignty of states, are both permanent, unyielding features of international relations, the distribution of power amongst states is the sole variable accounting both for the strategies of individual states as well as for the macro characteristics of the system (for instance its degree of stability).

Hoffmann (1966) argued that the processes of European integration could only be understood if one examined the 'interests' and 'power positions' of various national state leaders and their interests. The EU's historic intergovernmental agreements were not driven primarily by super-national entrepreneurs, or unintended spill-over from earlier integration, or transnational coalitions of interest groups; rather, it was a gradual process of interest convergence among the most powerful member states. This led to state leaders striking bargains among themselves, offering side-payments to smaller member states, and delegating only limited powers to supranational organisations. This ensured that supranational powers remained more or less obedient to member states interests while carefully guarding sovereignty. This was ensured, amongst other means, by the principle of unanimity voting in the Council of Ministers (Hoffman, 1966).

In this vein Alan Milward argued similarly that far from impeding on the sovereignty of its member states, the 1957 Treaty of Rome that founded the European Economic Community represented the 'European rescue of the nation-state' (Milward, 2000). As a treaty between mutually recognized states the treaty of Rome in fact helped to guarantee and solidify the independence of the fragile and war-torn European nations.

Thus, unlike neofunctionalism, intergovernmentalism takes seriously the international setting in which European integration is embedded. Nevertheless, the capacity of traditional intergovernmentalism to conceptualise global and structural transformations was still limited in as much as the latter goes beyond the mere ebb and flow of the international distribution of state power. Shifts in the balance of power such as the ones resulting from the end of the Cold War and the reunification of Germany feature into this analysis, however, structural changes such as globalisation, or again, financialisation which go well beyond the state structure, cannot be accounted for. Similarly, the explanation is still inherently deterministic in as much as its commitment to state-centrism and the consequent refusal to open-up to the possibility of domestic forces or transnational agents affecting state preferences and perceived interests limits its capacity to explain the particular choices made by states in response to structural change (Cox, 1986; Van Apeldoorn, 2002).

The seismic events of the 1970s seemed, at first, to undermine these prevailing conclusions about the causes of European integration (Haas, 1975; Wallace et al., 1983). However, while it is widely acknowledged that the collapse of Bretton Woods and global economic downturn in the 1970s was an epochal shift in the ideology and logic of economic governance, these events did not substantially change the theoretical conceptualization of how states reacted to it. Therefore, when it comes to IR theories of European integration, continuity rather than a break with old approaches is the hallmark of the recent literature that attempts to adapt and build upon these traditional approaches (for example see: Pierson, 1996; Tsebelis, 1994).

Thus, when Europe emerged from the prolonged economic upheaval of the 1970s with renewed efforts at integration in the 1980s, the so-called ‘second wave’ that crafted new powers and authority at the supranational level; it could have been seen as a substantively different form economic and political integration with separate causes, process and consequences from what came before. Instead, the prevailing assumptions and frameworks for evaluating European integration were simply adapted to reflect the changes in the global as well as European economies.

The most salient example of this is Moravcsik’s (1998b) Liberal intergovermentalism (LI), which is by far the most sophisticated state-centric approach to analysing regional integration. Moravcsik combines a liberal, rational choice theory of national preference formation with an intergovernmentalist analysis of inter-state negotiations. European integration is thus portrayed as a two-level game, in which governments hold the crucial role of ‘Gate Keepers’, mediating between the national and international levels (see Putnam, 1988). Finally, Moravcsik adds a component of liberal regime theory to his framework to account for the role of supranational institutions where European institutions provide states with a range of collective goods thus altering the cost benefit structures facing rational national decision makers (Keohane, 1989). In turn, states are prepared to transfer parts of their sovereignty to increase the efficiency of inter-state co-operation (Scharpf, 1997). They also accept the restriction of their external sovereignty, because these ‘institutions strengthen the autonomy of national political leaders, *vis-à-vis* particularistic social groups within their domestic polity’ (Moravcsik, 1993: 507; Tsebelis and Garrett, 2001) as well as vis-à-vis third-party rival states on the multilateral arena (Majone, 2001)

However particularly in the economic sphere competing  social forces are likely to pursue contradicting particularistic interest and entertain different ideas as to what would constitutes ‘an efficiency increasing’ policy outcome. Thus, precisely how national governments are able to aggregate sets of domestic competing interests, let alone how international preferences amongst different member states converge remains unaccounted for (Bieling, 2003; Holman, 2004). In relation to the neo-liberal (finance-led) Internal Market programme of the EU for example, Cameron (1992) points to the changes in the partisan composition of national governments in the early 1980s to explain the shift from Keynesianism to neo-liberalism. Most notably, Margaret Thatcher took office in Britain in 1979, but changes also took place in Belgium, the Netherlands, Denmark and Germany, and they ‘shared one feature in common: they all represented a shift toward a more conservative position’ (Cameron, 1992: 57).

Nevertheless, this does not explain why Mitterrand and the French Socialist Party decided in 1983 to remain in the Economic and Monetary System (EMS) whilst pursuing an economic austerity policy; neither does it account for the shift of other social democratic parties from Keynesianism to economic neoliberalism. The political platform of European Left changed significantly during the 1980s and this cannot be explained by pointing to structural and domestic events alone. Instead, the impact of neoliberalism as a set of economic ideas has to be investigated to explain the general turn to neoliberalism by parties of the right and left. The predominant emphasis on states as the main actors however, prevents LI from dealing with ideas and transnational actors as independent forces behind integration. The behaviour of TNCs, such as in the investment boom of the 1980s in the EU, is interpreted as rational adaptation to credible intergovernmental commitments, while policy ideas are viewed as the result of intergovernmental demands, but not as an independent force (van Apeldoorn, 2002).

Therefore, the major limitation of all types of intergovernmental theories on European integration is its exclusive focus on state preference formation and inter-state negotiations to the exclusion of other, equally relevant, developments that shape observed outcomes[4]. As a result, the 'European Project' is analysed as an exclusively political endeavour that is both formal and functional, in the sense that states use their institutional capacity in order to meet their perceived needs. As such, other factors and social forces are downplayed, or ignored altogether, because they make establishing causation effectively impossible.

Moreover, IR literature on European integration has become rigidly attached to common concepts and themes at the exclusion of new evidence that suggests a great deal has changed since the formation of the Coal and Steel Community or the Treaties of Rome. The prevailing frameworks for evaluating integration have solidified to the point that any case study (including financial integration and restructuring) can easily fit within the general consensus of the existing 'schools of thought'.

In particular, conventional integration theory has for too long been focused on the question of sovereignty transfer from the nation-state to an emerging supranational level, whereby the different 'schools' essentially debate the question of to what extent this is happening, and who or what might be driving the process. Such a *problematique* does not allow us to capture what John Ruggie has called the 'generative grammar' or 'structure' (Ruggie, 1982: 382) underlying a particular international order, a structure that constitutes the 'social purpose' served by this order: Whatever its institutional manifestations, political authority represents a fusion of power with legitimate social purpose.

[4] For example, Wincott points out that the convergence of preferences and therefore, instances of integration, are not so much the result of intergovernmental negotiations, but emerges from the 'everyday grind of the Community' (Wincott, 1995). In other words, the process leading to negotiations and agenda-setting should be seen as more important than the negotiations themselves, as should the sites of social struggle related to the negotiation and ratification of agreements.

These strictly political perspectives on European integration become especially are difficult to sustain when we consider that since the 1990s in particular financial integration and finance-led restructuring have been at the core of the European Project more generally. If European integration is something conceived of, and negotiated by, elite (national or supranational) political and beurocratic actors then how do financial markets influence this process? Also, if these elite actors are responding to economic changes in the same predictable way then how can we account for the diversity of outcomes in terms of patterns of accumulation?

The existing literature on European integration deals with these complex questions very simply: it offers separate, parallel, interpretations, or logics, of European integration. One addresses the political process of integration, which reflects the prevailing assumptions about why states choose to cooperate; and another which applies economic assumptions to the rationale behind financial integration and restructuring. Isolating these particular literatures attempts to show the degree of divergence between 'political' and 'economic' motives and interpretations of European integration.

## 1.2 European Integration as an exercise in economic efficiency gains

From the Exchange Rate Mechanism (ERM) to the present-day efforts to restore financial markets stability in the wake of the credit crunch, the process of European financial governance appear to run parallel to processes of political integration. This bifurcation of the 'political' from the 'economic' seem to belie any possibility of a viable social scientific theory of political economic change. Indeed, simply transposing the logic of state action onto a study of financial integration creates inconsistencies that cannot be easily overcome.

For instance, erroneously assuming that individual states assessed the needs of financial actors or markets in order to advance international competitive advantage through European integration does not stand up to even cursory scrutiny. Firstly, 'finance' is not a uniform sector or social actor. Finance can be currency exchange, equity investors, credit providers or speculators; and each of these aspects of 'finance' has different and often contradictory 'needs'. Secondly, it is by no means clear how elite political actors respond to these needs through their institutional capacity while simultaneously protecting their much coveted sovereignty.

As already suggested overcoming the substantial differences between the accounts of the motivations for political integration, which seeks to preserve sovereignty and augment political power, and financial integration, which seeks to establish a common market principles and governance strategies, is accomplished by separating them into different case studies to advance different theoretical claims. For example in a recent book Amy Verdun (2000) puts forward the notion that there are 'political' and 'economic' logics to European integration. On the one hand, political theories of integration focus on why it takes place at all. On the other hand, economic theories of integration focus on its forms or stages, of which she isolates four key areas of study:

(i) free trade areas, in which the associated countries agree to remove the barriers to trade between them but all may have different barriers to third countries; (ii) customs unions, in which a common external tariff is decided upon vis-à-vis non-associated countries; (iii) common markets, which embody a customs union and allow capital and people (labour) to move freely in the area; (iv) economic unions with centralized or harmonized decision-making concerning monetary, fiscal and other policy areas (p.18).

It seems that, for Verdun and for much of mainstream literature on European integration, these two approaches are logical extensions of simple disciplinary boundaries: political theories explain political processes of integration and economic theories explain economic processes of integration. This rings true when we consider that European economic integration is justified through an appeal to prevailing (orthodox) economic assumptions such as the benefits of economies-of-scale and the superiority of markets in allocating scarce resources.

This thesis deals specifically with one particular aspect of market integration namely financial integration, where the profound influence of *a priori* assumptions about the workings of markets becomes the basis of its political legitimacy. As such, understanding why Europe should engage in financial market integration and restricting requires the adoption of key tenets of mainstream (or orthodox) economics. Namely, that individuals always act as self-interested utility maximizers, by virtue of their *a priori* rationality (Brockway, 1991). Individuals cannot satisfy all their wants because of scarcity which imposes constraints forcing individuals to choose among alternative wants. Also, that the efficient working of the market is predicated on the price mechanism which transforms scarcity into efficiency. Price represents the equilibrium between what any individual buyer is prepared to pay and what any seller is prepared to accept. Since money is the universal equivalent for market interaction, or neutral in exchange, it serves only as a quantified expression of price, which all actors can understand (Corbridge et al., 1994; Neary and Taylor, 1998)[5]. The point at which all buyers and sellers agree on a price is equilibrium, which is the "best in the sense that any other allocation of goods and services would leave someone worse off" (see also Dugger and Hirsch, 1976; McCallum, 1996; Miller and Upton, 1974:11). Thus, the pursuit of self-interest within the market system will result in equilibrium and the social system is free of irresolvable conflict.

These precepts manifest on the national, regional and global levels as the multitude of micro-market transactions, based on rational preferences, abstracts to the interaction between all markets and creates general equilibrium (Mings, 1983). These assumptions about equilibrium are used as justification for 'laissez-fair' policies by governments because the idea that all markets are free from irresolvable conflict depends wholly on the free workings of the market and price mechanisms. Any attempt to control the workings of the market only results in distortions, i.e. anything can no longer be bought or sold with the same efficiency as in a free market (Loasby 1991). Moreover, if all agents (both buyers and sellers) act independently based on full and relevant information to maximize utility, predicting individual responses to changes in constraints is also possible by evaluating preferences among outcomes (Boland, 1992).

These precepts pervade all forms of economic analysis of European integration, but also form the feedstock of political support and opposition to financial integration. For example when we look at the political justification for the European Monetary Union it primarily revolves around the elimination of transaction costs as well as of currency risk (a major problem for many EU countries). Not only that, Monetary Union is supposed to support economic growth indirectly through monetary and price stability and its effects on long-term interest rates.

[5] This assumption is used as a rational for non-inflationary growth policies central to the neoliberal agenda, because maintaining the stability of prices by counter-acting inflationary pressures facilitates the efficient workings of markets

For example, The Single Market Program was politically supported because it would spur growth through two main channels: (1) a larger market size, which allows for the exploitation of economies of scale; (2) a more efficient resource allocation generated by stronger competitive pressures. Using this logic enlargement waves, especially those involving countries with an initially lower GDP per capita, spur growth through catching-up mechanisms, leading to higher capital accumulation as well as technology transfers from the centre to the periphery.

When we move from currency to investment and credit flows the economic logic of, and political support for, European financial integration rests on the notion that it will promote greater economic growth. This is because integrated financial markets allow for the efficient operation of the payments system, a necessary condition for transactions, and they contribute to the efficient allocation of savings by facilitating the interaction between agents with excess saving and agents needing external finance. In advanced economies, funds usually flow from households, (agents with excess saving), to firms, (agents with excess investment). By performing the function of saving allocation, financial systems affect growth through three main channels. They: i) grant credit and make new investments possible; ii) affect saving accumulation; iii) evaluate and select projects and firms to be financed leading to efficient resources allocation Levine, 1996).

Orthodox finance theory providers support not only for financial integration but also for finance led-restructuring and particularly disintermediation and active risk management. In a seminal text Goldsmith (1969) provided initial evidence for a positive correlation between the degree of financial development (at the time, considered exclusively with respect to bank intermediaries) and economic growth. He claimed this included, but was not restricted to, the choice of appropriate measures of financial development and their correlation to growth and the direction of the causal relationship between the real economy of trade and production and the financial sectors of economic systems. More importantly, Goldsmith's contribution has done much to frame further investigations and continue to inform and orient debates on the relationship between the financial sector and the real economy in mainstream economics to this day (Smith, 1994, 1995).

These assumptions were compounded by the advent of mainstream finance theory that advanced the theory of portfolio diversification (Gurley and Shaw 1960, and contributions by Tobin and Brainard, 1977). The basic tenet of the approach is that an efficient financial system must allow the lender to optimize risk diversification and that such a function can be carried out both by banks and by markets. From a theoretical point of view two different approaches can be singled out. One, based on neo-classical theory, identifies markets as the most efficient financial system in the long run; a second one, assuming asymmetric information in credit markets, attributes to banks a key role also in the more advanced stages of development. Looking at the empirical data, one can find evidence both for the supremacy of market-oriented financial systems peculiar to the Anglo-Saxon economies (Arestis et al., 2001), and for bank-oriented systems, peculiar to continental European economies and to Japan (Leahy et al., 2001).

There is wide agreement that banks play a key role in the initial stages of economic development. At such stage individual investors find it difficult to obtain efficient portfolio diversification as only few investment assets are available and are, often positively correlated. Furthermore, transaction costs associated with risk diversification are very large. Thus, when the economic system presents low levels of complexity, banks are especially fit to carry out the transformation of maturities, by issuing liabilities with a degree of liquidity higher than that of the assets they hold they are able to satisfy both small investors' demand for short-term assets and firms' demand for long-term liabilities. In such a context, banks perform this function most efficiently, as managing large debtor portfolios (a large amount of independent risks) enables them to face up to the insolvency risk of individual debtors (or simplify risks diversification) and, at the same time, exploit economies of scale that lead to lower unit transaction costs.

This point has been developed by Gerschenkron (1966), in discussing the relevant role played by banks in the industrial development of Germany and Italy at the end of the nineteenth century where they carried out the key function of transferring funds from savers to investors (firms). As evidence, Genschenkron points at the role of banks' very large investments in supporting German steel industry's development in the second half of the nineteenth century. He also notes that support was not limited to the supply of loans but it included banks' direct or indirect participation to firms' venture capital (universal banks). However, this latter role was temporary and justified by the backward conditions of the economy. Gerschenkron implicitly assumed that, in developed economies, internal resources, and therefore self-finance, are the most convenient finance instrument. In this perspective, past the initial stages, once the economy has reached a higher degree of complexity, investors are able to diversify their risk without necessarily resorting to intermediaries and market-oriented financial systems are perceived better equipped to support growth.

From a portfolio optimisation perspective, the increasing complexity of economic systems is associated with an increase in independent risks and a reduction in the correlation of different assets, so investors can exploit better risks diversification. As a consequence a direct relationship between lenders and borrowers becomes more attractive. This leads to financial deepening, fed by a progressive reduction in transaction costs, in turn facilitated by technological innovation. In other words, according to the dominant view, the structure of the financial system is determined by the stage of development and by the amount of independent risks. Development stages are to be seen as the different parts of one evolutionary process which evolving from a bank-oriented to a market-oriented system, rather than alternative paths.

Rybczynsky (1988) periodise three such stages. First, the transition from an agriculture economy to an industrial one is associated with a bank-oriented system. Second, in the maturity stage of the industrial system, credit finance coexists with direct finance while a gradual separation between firms' property and firms' control takes place. In a third stage, corresponding to the transition to a financialised growth regime characterized by an advanced degree of securitisation, banking is mainly devoted to individual lending and to off-balance-sheet activities. Firms obtain direct finance from savers and/or institutional investors that increasingly play a role in corporate governance and industrial restructuring.

The relevance of these theories to the process of European integration stems from the fact that they form the foundation of how financial integration and finance-led restructuring are pursued and legitimised in Europe. Specifically, these theories lend support a market-based system of credit and equity flows which is substantially different from the bank-based system that developed in European capital markets over the past century. Therefore, portfolio theory provided the 'guide posts' for financial market restructuring in Europe implemented under the guise of integration.

What is also immediately apparent is the incompatibility which emerges between the political and the economic logics of integration. On the one hand political theories of integration emphasize the incorporation of different actors, and their interests, into a common system of financial governance; whereas the economic logic of European financial market integration requires the creation of a single market framework markedly different from what already exists in European capital markets. Thus, essentially, European financial 'integration' is a misnomer, because these are process of re-structuring, not integration.

## 1.3 The Political Economy of Financial Integration and Finance-led Restructuring

So far we have seen two parallel interpretations, or logics, of European integration. One addresses the political process of integration, which reflects the prevailing assumptions about why states choose to cooperate; and another which applies economic assumptions to the rationale behind integration and finance-led restructuring. Isolating these particular literatures served to highlight the limiting nature of the intellectual division of labour between political and economic analyses, or in other words the internal contradictions that arise from the separation between states and markets in the conventional problematisation of European financial integration. It is with a view to overcoming these limitations that we turn now to the discipline of Political economy in search of explanations of European financial integration and finance-led restructuring.

As Richard Deeg rightly points out (2010: 11), although there is certainly still merit in differentiating between the domestic and international sources of financial transformations (i.e. on the basis of level of analysis), the distinction is growing increasingly blurred . Still, there are those who perceive change in domestic financial systems as largely driven by pressures arising from geopolitical and international economic competition (see Cohen, 1996; Djelic, 1998; Djelic and Quack, 2003; Simmons et al., 2008). Conversely, there are those who locate the key drivers for the globalisation of financial markets themselves at the level of domestic markets and national politics (McNamara, 1998; Sobel, 1994).

However, contemporary research has progressively focused on the interaction between international and domestic factors in their analyses of financial-led restructuring (for example Grahl, 2009; Graz, 2001; Jabko, 2006; Konings, 2008; Tickell, 1999). For this reason this review will follow the contours of the debate as outlined by Deeg (2010: 11-17), organising the literature along ideational, structural and institutional modes of analysis as opposed to levels of analysis. Importantly, these perspectives represent different ontological entry points into the analysis of European finance-led restructuring, but by no means are they mutually exclusive. In fact much of the literature does not fall neatly into one particular category, while at the same time under each label there is an uneasy mix of approaches which vary substantially from an epistemological perspective. Thus, for example while Deeg opted to focus on constructivist accounts of European financial integration when discussing ideational approaches, this chapter will emphasize neo-Gramscian forms of ideational enquiry.

### 1.3.1 Europe in a Neoliberal World Order: a Neo-Gramscian framework

> *'Most, if not all, analysts on the left now agree that 'neoliberalism' is the ideological expression of the reassertion of the power of finance...'*
>
> *(Duménil and Lévy, 2005: 17)*

This section outlines a 'critical approach' to the study of transformation that seeks to conceptualize the political and economic foundations of European integration, namely, the Neo-Gramscian framework for evaluating the transformative processes of global capitalism as it relates to European financial integration and finance-led restructuring. Neo-Gramscians, in particular, contributed to advancing a new *problematic* within the field of European integration, which explicitly focuses upon the *socio-political and economic* content of the integration process. This socio-economic dimension is to a large extent ignored by established neoclassical and mainstream International Relations approaches to the process of European integration inasmuch as these are mainly oriented towards explaining the *institutional* outcomes of the integration process. As such, the debate centres in particular around the question of whether integration is mainly driven by the interests of the member states or by a more autonomous supranational logic in which supranational institutions and actors play a predominant role.

Hence, what can be labelled the question of the 'social purpose' underlying the European order constructed through the integration process remains out of the analytical purview of the established theories. It is here that Neo-Gramscians contributed most to an alternative *problematique* in the study of European integration by focusing on the issue of social purpose, and arguing that such a *problematique* requires us to transcend the state-centrism inherent in conventional IR theory, as well as in the dominant (intergovernmentalist) approach to European integration, and to focus instead on the role of social forces (Bieler and Morton, 2001b; Van Apeldoorn, 2002).

Therefore, the social legitimacy of the nation state and of the supranational institutions of the European Union, however tenuous in the case of the latter, means that the policy discourse espoused by these institutions is widely accepted as the dominant understanding of the motives and outcomes of financial integration. As the only institutions possessing the material capabilities to affect widespread socioeconomic change, the prevailing ideology guiding their governance decisions is of outmost relevance to all the citizens of Europe. Since the signing of the Single European Act in 1986, committing to the goal of establishing a common European market, economic policy making and governance in Europe has predominately reflected the tenets of neoliberalism (Bieler and Morton, 2001b; Bieling, 2006; Eichengreen et al., 2008; Moravcsik, 1991, 1998a; Van Apeldoorn, 2002; Van der Pijl, 2006c).

In its most basic form, neoliberalism is a system of ideas that draws its philosophical roots from neoclassical economics and orthodox finance theory (Gill, 1995a; Harvey, 2005; Peterson, 2003; Saad-Filho and Johnston, 2005). For Neo-Gramscians, neoliberalism is the 'hegemonic' ideology insofar as it articulates the prevailing class interest but also guides policy makers and constrains policy choices. For example, Neo-Gramscians point to the ideological underpinning of the current European economic order as well as outlined the role of class agency in bringing about these changes which they consider to be a full frontal assault on the European labour class. These ideas are also intrinsically linked to Marx's ideas about bourgeois political economy, which universalizes capitalist relations of production by analyzing it in abstraction from its specific social determination and achieves its ideological purpose by dealing with society in the abstract (Wood, 1995).

Most Neo-Gramscian analysis see historic relations as related to social structure, opposed to defined capitalist or state structures. Moreover, it is rooted in the modes of thought, ways of seeing and understanding the social world, of individuals in all aspects of society. Thus, power in society rests with the ruling class and is partly exercised through the state. The state in Neo-Gramscian analysis differs from the Classical Marxist conception as it refers to the 'extended state', which attempts to reflect a fusion between both the dominant class and the state, and civil society and the state. The power of the ruling class is partly exercised through the 'extended state' through aspect of coercion and, more importantly, 'intellectual and moral leadership'(Gill and Law, 1993). Therefore, the theoretical and academic origins of an abstract political ideal like 'neoliberalism' provide the necessary intellectual and moral leadership which shapes the debates about how European integration happens.

Neo-Gramscian framing of European integration places a great deal of emphasis on the concepts of 'consciousness' and 'common sense' as indispensable in the formation of hegemony. A hegemonic order is one "where consent, rather than coercion, primarily characterizes the relations between classes and between state and society" (Ibid: 93). This does not imply an absence of coercion. On the contrary, coercion is always latent and is applied in marginal and deviant cases as to appeal to the sense by the subordinate group that there is no repression of their interest (Cox, 1993). In this case, hegemony is enough to ensure conformity of behaviour in most people most of the time. By way of contrast, a non-hegemonic social order is where different groups in society are vying to protect their interests in opposition to one another.[6] Therefore, the very notion of 'integration' requires the formation of a shared common sense between various (usually elite) social actors.

[6] Gramsci explains "corporativism" in terms of non-hegemonic social order (Gramsci 1971: 255-6). Gramsci analysed in particular how parliamentary government changed how the aristocratic class in society related to the state and civil society. In this case the aristocratic class, having lost all their in-born influence with the onset of democracy, began to use their wealth, in a strict monetary sense, to exert influence in the processes of the state.

Admittedly, one of the criticisms of the Neo-Gramscian is its exclusive focus on elites as the primary drivers of political and economic change (Hobson et al., 2007). This focus on elites derives from efforts to isolate the transnational forces at work in creating and solidifying the neoliberal consensus on forms of economic growth and political organisation (Cox, 2002). Robert Cox's (1995) concludes that, "world hegemony is expressed in universal norms, institutions and mechanisms which lay down the general rules of behaviour for states and for those forces of civil society that act across national boundaries (to create rules that support the dominant mode of production)"(Cox and Sinclair, 1995:63). Cox's interpretation of neoliberal hegemony isolates the various economic, political, and social structures that act to support dominant groups' interests at the international level. Therefore, consent is engineered through European institutions, where the dominant state (or group of dominant states interests) create a world order which is compatible with current capitalist system, and which is compatible with the operation of the subordinate states.

The neo-Gramscian critical understanding of the current neoliberal hegemonic project sees the international as a means of political consolidation which "reflects an international congruence of objective and subjective forces" (Gill, 1992:278). The international configuration of the neoliberal historic bloc should be understood as being embedded in modes of thought and social structures, rather than a national bloc because of its need to transcend national barriers, "this means that the alliance of social forces it comprises is seen, to a large extent, as 'natural' and legitimate by most of its members" (ibid). Thus, this process entails the spatial expansion and social deepening of economic liberal definitions of social purpose and possessively individualist patterns of action and politics (Gill, 1995b:399).

The creation of hegemonic order involves the economic rule of the dominant class, which is accepted as legitimate by the subordinate classes, that is, there is a relative consensus for bourgeois rule. The concept of hegemony stresses the naturalization of bourgeois political economy and consciousness. The existence of hegemonic leadership in a social order can create the necessary conditions for an historic bloc. The movement from hegemonic leadership to historic bloc is progressive and reciprocal. The historic bloc is seen as the organic link between the political, ideological, and economic spheres, and civil society (Gill and Law 1994: 94). It operates as a fusion of material, institutional, inter-subjective, theoretical and ideological capacities of the dominant social group in a particular social order.

Thus, from a Neo-Gramscian perspective, historic relations are related to social structure, opposed to defined capitalist or state structures. These are rooted in modes of thought and ways of seeing and understanding the social world for individuals in all aspects of society. An historic bloc is the 'organic link' between the political and civil society a collaboration of the interests of the dominant class in these various groups. An historic bloc is created when state and society constitute a coherent whole of ideological supremacy and the structural means to support the prevailing ideas.

These forces can be seen to operate in the current world system at the international level, domestic political level, and the relations of production. All three dictate the current hegemonic project of neoliberalism, at both the ideological and material level. The concept of 'disciplinary neoliberalism' furthers this claim by focusing on the combined macro and micro dimensions of power: "the structural power of capital; the ability to promote uniformity and obedience within parties, cadres, organizations, and especially in class formations associated with transnational capital" (Gill, 1993a:411). Thus, disciplinary neoliberalism is a concrete form of structural and behavioural power; it combines the structural power of capital with capillary power of global surveillance.

When assessing the processes of European integration Neo-Gramscians emphasis three key forces: ideas, institutions, and material capabilities. The relationship between these three forces is reciprocal not determined. The direction and strength of these interconnections can only be evaluated in terms of the historical particularity of each phase, country and events that shaped the multiplicity of processes that make up 'European integration'. Ideas are the shared notions of social relations, such as market efficiency, as well as collective images of social order within European societies. The constellation of institutions that make up the European Union reflect the power relations prevailing at a particular time, be it the 1950s, 1970s or the present-day, to encourage collective images consistent with existing power relations. Material capabilities denote how resources are deployed and have the power to affect structural change. These three forces continuously change and transform the parameters of social struggle. Which social group's ideas are represented within institutions influences the power of this social group to manipulate collective images within society, allowing their interests to appear natural and legitimate. Similarly, the material capability of actors to affect change means that the ideas which dominate state governance strategies will influence the configuration of power with in a particular historical structure.

Analysing historical structures in this way draws interconnections between power and individual human actions. The existence of limited historical totalities means that individuals' actions are never absolutely free because they operate within historical structures. These structures do not determine individuals' actions in any mechanical sense, but they constitute pressures, expectations, and constraints within which action takes place (Cox, 1993). The impact of power on individual action is evaluated through the existence of collective habits and patterns of behaviour.

Therefore, power, as a whole, is examined through the various parts of its social expression. In doing so, one is able to enquire into the origins of historical structures and the possibilities of structural transformation (Bieler and Morton, 2004; Cox, 2002). Each historical phenomenon is examined within the context of its own peculiar characteristics, rather than conflated with other historical events (Gramsci, 1971:330-1). This entails recognising the seeds of the past in the constitution of power in the present, to account for the roots of historical change (Bieler and Morton, 2001a). "Each individual is the synthesis not only of existing relations, but of the history of these relations" (Gramsci, 1971:353). The centrality of ideas in influencing power within an historical structure provides a unique interpretation of agency within social transformation.

This framework indeed provides a rich body of research on many unexplored aspects of European integration and has done contributed much to advancing a focus on the socio-political content of European integration as opposed to its form as well as to uncovering and re-politicising the neoclassical ideological discourse which underlies it. For example, Kees van der Pijl (2006c) analysis of transnational class relations and its influence of the formation of the European project; Van Appledon's (2002) extensive research on the European Roundtable of Industrialists shows how ideas and material capabilities work within the European institutional processes. Moreover, the extensive work by Andreas Bieler and Adam Morton (2004; 2001a; 2001b) elucidates the multifaceted ways in which social forces constitute and act upon the multiplicity of processes entailed in European integration.

However, what remains severely under researched in this theoretical agenda is an account of European financial restructuring (for one particularly notable an exception see Bieling, 2006; Bieling and Jäger, 2009; Bieling, 2003). To be sure, Stephen Gill (1998) as well as Hans-Jürgen Bieling and Johannes Jäger do go some way towards exposing the social forces who are the key drivers and main benefactors of neoliberal finance-led restructuring at the EU.

However, the otherwise excellent contributions of Gill and Bieling are representative of Neo-Gramscian analyses more broadly in its commitment to a productionist framework in which the forces of production remain the single most important determinant of class relations. Thus, any consideration of finance, comes as an extension of broader capitalist accumulation logics derived from notions of surplus-value extraction. Thus, without a clear conceptualization of how labour interacts in relation to finance, this conceptualization is tenuous at best. Moreover, without addressing European financial restructuring for its own sake as opposed to with respect to the social relations of production this rich body of literature remains woefully incomplete.

### 1.3.2 European Finance in an American Mirror: a Structural Framework

> *'…the dynamics of the American model provide a useful template against which to examine developments elsewhere… …because by the time that European finance was emerging from its Fordist subordination to industrial production, American finance had already embarked on a course of expansion that was reshaping the norms, practices and institutional structures of the global financial system to their core'. (Konings, 2008: 257)*

Structural, or systemic, accounts of financial integration and of finance–led restructuring, whether espoused by mainstream European policy makers or by critical International Political Economy scholars attribute domestic change in financial systems to the inevitable forces of market competition operating at the global marketplace. A common starting point for such analysis, is rooted in the re-emergence of international capital mobility following the breakdown of the highly regulated international monetary system of the Bretton Woods era (so-called 'embedded liberalism') (Armstrong et al., 1984; Cohen, 1996; Helleiner, 1994; Ruggie, 1982; Strange, 1986).

Capital mobility, so the argument goes, has contributed to the shifting balance of power away from states and other holders of tangible and immobile assets (e.g. labour) and in favour of owners of more intangible and mobile assets such as financial capital (Nitzan, 2001). The latter can now presumably demand further reform and liberalisation, generating further investment and profit opportunities, or else threat to exit and relocation to a more cooperative sovereign territory. The ensuing competition for capital forces states to adapt their market regulations in line with the most liberalised states (Cerny, 1993; Cerny, 1997; Palan et al., 1996; Stopford et al., 1991; Strange, 1994). In this light change in financial markets was therefore driven by a self-reinforcing structural market process with the unmistakeable consequence of dramatic expansion of global financial markets and transnational financial flows.

Of course mainstream policy discourse and critical IPE diverge radically with respect to their normative perspective on these developments. European policy makers adopted the philosophical tenets of neoclassical economics to legitimate the agenda of further financial liberalisation and integration[7]. Thus, pursuing further financial restructuring is portrayed as a necessary pre-condition for realising the potential benefits of the Single Market. This attitude is epitomised in countless policy documents, speeches, etc. emanating both from the institutions of the EU (and the commission above all) as well as by key members of national member state governments and financial regulators, for example*:*

> *'the integration of financial markets across community borders is uniquely important, however, in the sense that it will not only have important effects on the efficiency of the sector itself but also on the efficiency of resource allocation of sectors using financial markets'* (European Commission 1988: 86).

[7] Policy agendas founded on neoclassical economic theory are often referred to as neoliberal.

Critical IPE literature, on the other hand, reaches diametrically opposed normative conclusion. In this view financial globalisation reflects the succession of the Bretton Woods Regime by the global hegemony of the so called *Dollar Wall Street Regime* (Gowan, 1999; Panitch and Gindin, 2004; Panitch and Konings, 2008). Thus, as Martijn Konings puts it, by the time European governments *'…began to reconsider some of the basic institutional parameters of their models of welfare capitalism, they were already operating and making decisions in a global context of financial networks that had been profoundly shaped by the Americanization of its basic rules, practices and techniques'*. (Konings, 2008: 263).

European financial restructuring has therefore pushed a variety of actors to re-orient their strategies around institutional forms and dynamics driven and shaped by the globalization of specifically Anglo-American finance, and has further facilitated the penetration of European economies by American capital, effectively incorporating them into the domestic capital circuit of the USA (Schwartz, 2008; Seabrooke, 2001). Lastly it has been suggestef that the processes of finance-led restructuring in Europe have served to erode the coherence and viability of old institutional configurations, yet do not amount to a full animation of a new and coherent growth regime, thus posing direct threats to the sources of European productivity growth and innovation, and has had an overall depressive structural effect on economic growth and social cohesion for Europe (Bieler and Morton, 2004; Bieler and Morton, 2001b; Bieling, 2006; 2009; Cafruny and Ryner, 2007b; Van Apeldoorn, 2002).

However, while capital mobility has indeed been established as 'one of the defining—the constituting, the proper—practices of a developed country', (Abdelal, 2006:15), this structural transformation did not in itself account for the rise of a myriad of micro level strategies and practices at the level of individual banks, non-financial firms and even households across Europe which are ultimately the subject of this research. Likewise the dominant role of the US in global financial markets is undoubtedly beyond reproach; however, the claim that these micro level changes can be explained simply on the basis of 'strategic emulation' does not stand to empirical scrutiny. Rather, the emergence of new, financialised, micro level strategies of accumulation and social reproduction in Europe required and depended upon, the establishment, or reform, of a host of supportive (extra-market) public and private institutions.

Thus, European financial integration and finance-led restructuring is certainly bound by a structural logic, and particularly by the structural power of Anglo-American finance. However, if we are to account for the persistence of diversity across Europe in the face of common structural factors, and even more so for Europe's active and influential role in pursuing further financial liberalisation and restructuring across the globe, we must turn our attention to the European public and private institutions which facilitated and supported these processes.

### 1.3.3 Varieties of European Financial Capitalism

If structural explanations conceptualise financial integration and finance-led restructuring in Europe as a response to the competitive pressures emanating from the global market, institutional analysis conversely emphasizes the domestic and regional market and political sources of change, thus reversing the image and implying that financial globalisation itself is essentially driven by a summation of micro level strategies and domestic institutional configurations (McNamara, 1998; Palan, 1998; Palan and Cameron, 2003; Sobel, 1994). Thus, in analysing financial transformations, institutional modes of enquiry focus on the interaction between the agency of actors and pre-existing institutions in shaping both domestic and international financial market structures and regulation (Moran, 1991).

During the past two decades in particular, institutionalist, 'Varieties of Capitalism' (VoC) scholars, have been especially prolific in studying the relationship between the continental European and Anglo-American trajectories of financial development and accounting for the occurrence of institutional change in financial systems across the world. (see for example Aoki, 2001; Culpepper, 2005; Deeg, 2009; Lütz, 2004; O'Sullivan, 2007a; Posner, 2005; Vitols, 2004). The main claim of the VoC literature is that, contrary to widely-held beliefs, institutional specificities continue to matter and matter greatly, even in an era of economic globalization. Contrasting its position with both, the mainstream neoliberal and critical IPE understandings of the dynamics of financial globalization and the operation of markets, the VoC literature has been instrumental in deflating the myth of globalisation as a material-economic monolith, undermining the viability of the continental European 'variety of capitalism' and imposing neoliberal convergence on Europe's nation states (Amable, 2000; Appel, 2004; Hall and Soskice, 2001; Morin, 2000; Vitols, 2004a; Zysman, 1983).

The VoC perspective, maintains that the structure of financial systems, as well as transformations and finance-led restructuring should be understood in the context of the broader model of production characteristic of the economy (Amable, 2000; Hall and Soskice, 2001; Hancke et al., 2007). The concept of institutional complementarity denotes that institutional change will either spillover  throughout the system, or will be remain minimal because the competitive advantages vested in the existing system drive actors to resist more radical change (Deeg, 2010). Using this schema it has been argued that in many cases the European institutional frameworks of corporatism, welfare states and bank-based financing in fact offer a good match for the forces of globalisation. Not only that, economic globalisation provides both constraints and opportunities for European political and economic elites, and can be engaged with in a socially progressive manner. Moreover, this approach often decries the many forfeited opportunities for market regulation owing to a mistaken belief in the myths of globalization (Weiss, 1998).

The most common, if somewhat rudimentary, typology of financial systems identifies two ideal types – bank-based and market-based financial systems (Allen and Gale, 2000). In the former, financial intermediaries dominate all the various segments of financial markets and financial activity, including corporate finance, retail banking often including housing and retirement finance, underwriting, and securities trading on their own and their clients' behalf (asset management). Financial intermediation ratios (showing up on banks' balance sheets in the form of deposits and loans) tend to be high, as household savings is channelled largely through the banking system while the use of equity in corporate finance is typically limited and the reliance on bank loans relatively high.

In some cases banks also play a prominent role in corporate governance, exercising influence over firms via large equity stakes and seats on company boards (Rajan and Zingales, 2002). In the later, borrowers look much more towards on markets for equities, bonds or other instruments to secure external financing (as opposed to bank loans). In market-based systems ownership of firms tends to be more widely dispersed between greater numbers of minority shareholders. Diffuse ownership, in turn, makes management more vulnerable to market discipline in the form of declining share price in the case of equity financing or credit rating downgrade in the case of debt securities.

At its most basic variant, The VoC approach distinguishes between two ideal type national political economies – liberal market economies (LME) and coordinated market economies (CME) (Hall and Soskice, 2001). Both types rest on a distinct set of complementarities among the institutions governing finance, firms, and labour markets which, in turn, lead to diverse firm and national competitive advantages (for a review of this literature see Jackson and Deeg, 2008). Firms in LME generally have a comparative advantage in so called radical innovation – complemented by flexible or minimal employment protection law and higher risk oriented market-based systems and are thus able to quickly reallocate capital and labour to new purposes. Firms in CME generally tend to exhibit a comparative advantage in so called incremental innovation, taking advantage of higher levels of investment in human capital and more bank-based financial systems able to provide 'patient capital'.

Looking at patterns of firm finance across Europe however, the bank versus market distinction becomes much more difficult to sustain. Victor Murinde et al. for example identify an across the board long-term shift toward increasing self-finance and market finance at the expense of bank loans (Murinde et al., 2004). However, when controlling for firm size Deeg finds that in some continental European countries (Germany for instance) this trend only really applies for large (and particularly multinational) companies. Looking at Small and Medium Enterprises (SMEs) the old distinction seems to be holding fast (Deeg, 2009). Even so, country by country variation across Europe is itself on the rise. In France, for example, both large and small firm finance have moved significantly towards market-based financing (Culpepper, 2005; O'Sullivan, 2007b). Moreover, looking at the overall rise in self-financing by French firms demonstrates that in fact the French pattern of firm financing is even closer to those of the UK and US than initially anticipated (Byrne and Davis, 2002).

In sum, the VoC literature is at its strongest when it comes to analysing how systemic characteristics of finance complement the organisational and market strategies of non-financial firms (which underlies the central distinction between bank-based and market-based financial systems). That said, the extensive and rapid finance-led restructuring over the last two decades raises questions as to the continued relevancy of these categorisations and furthermore calls into question whether financial systems and strategies of non-financial firms are still characterized by the same degree of institutional complementarity.

Furthermore, deriving its conceptualization of finance via Arrighi (1994) and Gerschenkron (1966) from Hilferding's (1981 [1910]) notion of finance capital as the functional imbrication of finance with productive capital, the VoC literature evaluates financial systems primarily in terms of their efficiency in channelling society's savings into productive investments. This productivist bias is problematic insofar as it means that the VoC literature almost by definition comprehends contemporary processes of financial expansion which are often unrelated to increases in productive investment as speculative and dysfunctional to the healthy development of real economy of production and trade (Engelen and Konings, 2010; Konings, 2008; Stockhammer, 2004).

## Conclusions

The prevailing interpretation of European integration within IR focuses on power [that is, state power] only; it ignores the dimension of social purpose. The problem with this formulation is that power may predict the *form* of the international order, but not its *content.* Furthermore the hiving off of the study of European financial integration and finance led restructuring into 'political' and 'economic' logics which run in parellall generates more problems than it solves.

Neo-Gramscian ideational approaches have been most instrumental in advancing a new *problematic* within the field of European integration, which explicitly focuses upon the hither though neglected *socio-political and economic* content of the integration process as opposed to its *institutional form*. At the same time the Neo-Gramscian conceptual framework remains committed to placing the social relations of production at the core of its analysis and therefore has thus far failed to address the question of finance-led restructuring on its own terms beyond its implications for class struggle.

Structural IPE perspectives have highlighted the institutional roots of finance-led restructuring in practices and strategies which developed organically in the US and have therefore served to highlight the importance of the trans-Atlantic dynamic of geopolitical rivalry as an important source for the pressures for finance-led restructuring now operating within Europe. That said, finance-led restructuring in Europe can hardly be regarded as the automatic outcome of adjustment to global competition, or even the semi-automatic adjustment suggested by the notions of strategic emulation of the more successful institutional configuration denoted by the Dollar Wall Street Regime.

Finally, as it emerged from the last two sections, the contours of the debate between structural and institutional logics on financial integration and finance-led restructuring have, to a large extent, been defined by the differing appraisals of the relative strength of global financial markets versus national (or regional) socio-political institutions. As Konings notes, in an important sense, these rivalling interpretations of processes of financial integration and financialisation in Europe occupy opposite poles of a Polanyian understanding, *'…in which markets are seen as characterized by an expansionary, disembedding logic and political institutions are viewed as society's instruments to (re)-embed the market and subordinate it to social and political purposes'* (Konings, 2008a: 254).

However, (diverging normative perspectives notwithstanding), this more or less empirical disparity could only be upheld on the basis of a mutual (often implicit) understanding of how markets and institutions are constituted and interact. One of the key tenets of critical political economy in general, and Institutional approaches in particular, is that markets are themselves institutionalized processes. However, that said, both structural IPE and Voc literatures focus overwhelmingly on the role of socio-political institutions in constraining and regulating markets. The logic of markets is thus implicitly contrasted with that of social institutions – and the state institutions above all others. In contrast, both approaches neglect the role of institutions in constituting and facilitating the proliferation of financial market relations. This research project takes its cue from the growing number of authors whom in recent years highlighted this tension within International political economy and seeks to advance the debate by dispensing with the constrictive assumptions of rational choice theory in favour of a political economic perspective which focuses on the constitutive role played by state and EU institutions for the proliferation of financial market relations and their increasing permeation of evermore spheres of social life

# Chapter Two Living in Financial Times—Financialisation and Finance-Led Growth in Contemporary Capitalism

## 2.1 From an Industrial-led to a Finance-led Growth Regime

The concept of a finance-led growth was originally introduced and developed in the works of French Regulation School scholars, addressing the transformations of Atlantic capitalist state formations during the 1990s (Aglietta, 2000; Aglietta and Breton, 2001; Boyer, 2000a; Boyer and Durand, 1997; Boyer et al., 2002). The theoretical foundation of the regulation approach is rooted in an essentially Marxist outlook on capitalism as a form of social organization and capitalist accumulation processes as based on exploitative class relations. Following Polanyi (Polanyi, 1944), the regulation approach treats the processes of capitalist accumulation and reproduction as distinct and separate social forms. The tensions between accumulation and reproduction within the capitalist social system emanates from the fictitious nature of the commodofication of labour power; *"While labour power is bought and sold in labour markets, it is not itself directly (re)produced in and by capitalist firms with a view to private profit"* (Jessop, 2006: 143).

This approach was developed as a critique of the dominant economic theory by highlighting its inability to analyse economic processes in terms of time lived by subjects. In other words to give an historical account of economic facts; and, secondly, its inability to express the social content of economic relations, and consequently to interpret the forces of conflict at work in the economic process (Aglietta, 1979: 9; Lipietz, 1983, 1987). In the first instance, this approach manifested itself as a critique of the concept of equilibrium in economic theory because it excludes the observation of real practices as simple market 'imperfections'(Boyer et al., 2002).

For regulationists, the processes capital accumulation are inherently contradictory and fraught with conflict; thus shifting the emphasis from explaining the recurrence of capitalist accumulation crises, central to mainstream economic analysis, to a focus on explaining the stability and resilience of the capitalist form of social organization. Indeed, they point to the fact that periods of *"full employment and a strong, stable rate of growth are the exception rather than the rule"* (Boyer 2002:17).

For regulationists, the reproduction of capitalist systems is contingent upon extra-market, historically, spatially and socially specific, mechanisms of social mediation, which stabilize capitalist accumulation and give it social purpose. As such, regulation theory rejects the ahistorical and universalizing nature of neoclassical economics by addressing the specific mechanisms that have allowed the continual existence of distinct capitalist forms of social organization despite recurring large scale crises and political unrest(Aglietta, 1979).

The tenets of accumulation are based on the social relations of production, class relations, and exploitation, which are adopted from the Marxist perspective. But the régulation conceptualization of the process of reproduction of the capitalist system, as contingent upon historical social forms present in any society at particular points in time, tends more toward institutional analysis, thus avoiding the functionalist and teleological tendencies evident both in mainstream economics and classical Marxism (Basel, 2001; Palan, 2006).

The concept of regime of accumulation is central to French Regulation School analysis; regimes of accumulation are historically and socially specific constructs in so far as that the institutions and cultural habits which reproduce a particular capitalist society can and do vary spatially and temporally (Boyer, 1990). The initial regulation research project analysed how economic relations became socially and politically embedded in the context of the Atlantic Fordist regime of accumulation. The Fordist, industrial-led growth regime was based on the co-constitutive forces of mass production and mass consumption of consumer durables, made coherent by a capital-labour wage compromise (Aglietta, 1979; Maier, 1977). This compromise assured the relative stability of income distribution by indexing wage increases to productivity growth and therefore also assured sufficient aggregate demand (Armstrong et al., 1984). Economic and social governance were premised on national, Keynesian demand management mode of regulation, and the accompanying establishment of 'a social safety net' in the form of the welfare state, prompting the political discourse of the 'Keynesian Welfare Nation Sate' or KWNS (Jessop, 1995b; Jessop, 1997, 1999).

However, 'the term "regulation" gives a name to the stabilization of a fundamentally contradictory and conflictual process without removing its underlying contradictions' (Görg and Brand, 2000: 374). The contradictions reproduced through the mode of regulation will therefore at some point unhinge the compromises around which the accumulation regime is built. As to Fordism, two forces signalled the unravelling of this accumulation regime. First, the crisis of productivity and consequent stagflation which plagued the Atlantic Fordist economies during the 1970s, demonstrated that in its original areas of implementation, Fordist/Keynesian growth strategies could no longer accommodate the competing interests of capital and labour and ensure stable and sustainable accumulation and growth. The 'creeping inflation' inherent in this system led new actors, most notably financial actors as well as states and corporations, to coalesce around the unifying call for the vanquishing of inflation as both a political and economic objective (Aglietta, 1998; Lipietz, 1983).

Secondly, the geographical push to new zones of implantation beyond the North Atlantic political economy. This search for new zones of exploitation of labour entailed the transplantation of productivist processes of accumulation to increasing number of peripheral economies. The aim of this geographical expansion was to escape the 'class compromise' underlining the social mediation of accumulation in the core. Thus, wages in these host economies were not indexed to productivity gains but were rather kept at a low level in order to maintain profitability, capital accumulation and price stability (cheap imports) in the core economies. This form of exploitative expansion was dubbed 'peripheral Fordism' (Lipietz, 1987).

The consequence of these responses to the crises of the 1970 was a re-organization of the hierarchy among the existing institutional forms, which created a twenty-year period of ideological and institutional contestation lacking regularized, or coherent, forms of economic organization (Boyer and Coriat, 1984; Boyer and Mistral, 1984; Lipietz, 1988; Lipietz, 1989, 1990). It wasn't until the early 1990s that a new set of regularized, and generalizable, forms of interaction between various institutional form and social mediation mechanisms became sufficiently consolidated, to allow talking about the emergence of a new regime of accumulation.

Thus, the so-called 'new economy' was the entry point for régulationists to argue for the emergence of a finance-led growth regime (Aglietta, 2000; Boyer, 2000a, b, 2004; Boyer, 2005; Boyer and Durand, 1997; Dumenil and Levy, 2001; Dumford, 2000). In the words of Michel Aglietta 'it is our contention that such a change in the growth regime did occur in the last twenty years and that the most important institutional driver has been financial liberalization, which should be viewed as the nexus of the new economy' (Aglietta and Breton, 2001: 435).

This new form of regulation, it was argued, was structurally distinguishable from Fordism. The academic endeavour was to find the distinctive and durable features of a finance-led growth regime. The core regulatory feature of finance-led growth replaced the wage/productivity nexus with a financial/stock market nexus, where economic expansion is based on channelling international credit through investments and distributing wealth through equity markets. The basis of innovation in finance changed the inner logic of accumulation through the supply of financial services(Boyer, 2002; Boyer, 2005). The types of financial systems promoted by financial liberalization have, in turn, impacted upon corporate strategies, so that the interrelations between capital accumulation and financial variables have changed significantly (Aglietta and Roberioux, 2005). This fundamental change created a new set of institutions and regulating mechanisms that led to alterations in macroeconomic performance, productivity trends, income distribution, capital accumulation and the type of fluctuations experienced in the business cycle (Aglietta and Breton, 2001: 435).

Crucially, the adoption of these regulatory principles was not conceived as purely structural, it was based on a political movement to reject various elements of Keynesian demand management and the 'embedded liberalism' of the welfare state, in favour of a supply-side, investment-led growth strategy. The goals of full employment and welfare, central to the Fordist-Keynesian growth regime were thus to be replaced by the pursuit of regulatory reform (particularly of financial services and labour markets), aimed at facilitating increased capital mobility, and 'flexible' labour markets, deemed favourable to investment. Proponents of this view envisaged deregulated international capital markets, which would allocate credit based on efficiency and innovation, and equity markets which would distribute the corresponding efficiency gains and wealth throughout the economy (Cerny, 1993; Jessop, 1995a, b; Jessop, 1999; Jessop, 2006).

This translated into the emergence of a new regulation mode that "…combines norms of shareholder value, labour market flexibility, price stability, and a booming stock market fuelled by credit to sustain the rapid growth of consumption, as well as the permanent optimism of expectations in firms" (Boyer, 2000a: 116). For Boyer, the imposition of these financial norms meant a new and coherent mode of governance of firms, forms of competition, as well as changed objectives for monetary policy, public budget, and the tax system. An essential element of this strategy was the partial abdication of government's role in the overall governance of the economy. Instead, new power was given to central banks whose responsibility for controlling inflation, setting interest rates and monitoring of the health of the financial sector overpowers these governments' fiscal prerogatives (Watson, 2002).

Thus, the motivation and orientation of firms in a finance-led growth regime revolve around maintaining international credit ratings and increasing shareholder value. Financial market forces exert pressure on firms' management strategies. Preserving a viable credit rating and establishing ever-increasing returns to shareholders requires management strategies of firm downsizing, outsourcing, and restructuring to elevate share prices. Ultimately, promoting the interests of creditors and shareholders has become essential to firm profitability in a finance-led growth regime. Similarly, the traditional role of banks as intermediaries between savings and investment has transitioned into the direct trading in debt and equity markets and continued use of securitization to re-capitalize credit pools. This means that the process of finance-led restructuring has impacted the financial and non-financial sectors in the same way, orientating both toward finance-based accumulation strategies (Crotty, 2000; Dumenil and Levy, 2001; Dumenil and Levy, 2004; Stockhammer, 2004).

Moreover, the emergence of a finance-led growth regime has created diverging and competing roles for the household in the economy. Under Fordism the household sector had the integrated purpose as worker/consumer, a source of profitability as labour and as consumer of end products. In a finance-led growth regime households have a dual role as worker/shareholder and cost-of-production for firms (Aglietta 2000). Increased access to credit and equities (directly through stock ownership and indirectly through pensions and mutual funds), has made households more integrated into the financial system, but they are also subject to pressures of profitability which requires restructuring and employment flexibility (Langley, 2003; Montgomerie, 2006b; Montgomerie, 2008).

These conditions mean that a general decline in wages, as a share of output, are supposed to act as a Keynesian stimulus for households via the wealth effect generated in equity markets (Grahl and Teague, 2000: 170). Meaning the eclipsing of the wage compromise can only be successful if the negative impact of wage cuts is counterbalanced by positive effects arising from asset price appreciation: "what worker/shareholders lose through wage cuts could be compensated by the gains of shareholder/workers asset price appreciation" (Froud et al., 2000b; Froud, 2000; Froud et al., 2001; Williams, 2000: 9).[8]

This conceptualization of an emergent finance-led growth regime challenges both mainstream and critical IPE arguments about the consequences of the rise of global finance since the 1970s. The mainstream literature has emphasized the 'efficient market hypothesis' whereby the liberalization of financial services has led to a more productive allocation of credit within the economy, leading to innovation and economic growth. Moreover, the concept of financialization redresses the ubiquitous paradigm within IPE that, as a consequence of the 'resurrection' of global finance, there has been a 'decoupling' of finance from the real economy(Cohen, 1996; Helleiner, 1994). The concept of decoupling is based on a narrow methodological focus on the changing structure of financial markets, either through political or strictly economic means, and how these have fundamentally changed the supply of finance. This, in turn, has led to the conclusion that finance has become dominant over the 'real' productive economy as well as state prerogatives (Bonefeld and Holloway, 1995; Cohen, 1996; Dombrowski, 1998; Frieden, 1991).

Therefore, within IPE literature, finance has been systematically hived off as a unique 'space' and analysed in terms of an elite process of a highly technical nature, whereby nameless and faceless actors have been able to exert change on the existing power relationships whereby states, firms, or households can merely stand back and watch (Palan, 1998b; Palan and Cameron, 2003). This conceptualization of decoupling over-generalizes the degree of separation of the financial markets from real economy (Konings, 2008).

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[8] The concept of an asset owning democracy has been introduced into public popular debate by Minister of the Exchequer, Gordon Brown and forms a pillar of 'New Labour' philosophy.

## 2.2 Antecedence of finance-led growth

The concept of finance-led growth has also contributed to the overall research project of the French Regulation School by expanding its framework from its original analysis of Fordism to the present day. This has resolved many earlier debates about the viability of the concept of post Fordism as well as given more scope to address previous critics of the school's tendency toward *ad hoc* functionalism and structural logics (Palan, 2006). In this way, the concept of finance-led growth has both addressed existing deficiencies in the current IPE literature's analysis of the implications of the rise of finance as well as bolstered the theoretical framework deployed by régulationists. It has done so by integrating its core theoretical concepts, originally developed by analysing post war American Fordism, into an a critique of what the rise of global finance has meant to the overall configuration of power relationships in the Anglo-American economies, in particular, and the global political economy, in general.

The historical analysis of this process is interpreted in terms of political action, failed attempts (i.e. Monetarism), and unknown outcomes. As Alain Lipietz (1987) argues, capitalism may evolve through identifiable stages and phases, and these may be associated with certain structural tendencies, but these tendencies should not be causally and (casually) linked to historical outcome. On the contrary:

'[t]he important point, however, is that the emergence of a new regime of accumulation is not a pre-ordained part of capitalism's destiny, even though it may correspond to certain identifiable 'tendencies'... Regimes of accumulation and modes of regulation are chance discoveries made in the course of human struggles ... So the history of capitalism is full of experiments which led nowhere: aborted revolutions, abandoned prototypes and all sorts of monstrosities' (Lipietz 1987: 15).

In terms of the tendency toward structural logic that prioritizes structures over agency in the régulation approach, it must be remembered that régulationists regarded economic laws as mediated in and through specific institutions and practices. According to Jessop (1997) the theoretical work of régulationists has shown that the so-called 'laws' of capitalism are, in fact, "doubly tendential, in that they operate as tendencies (with counter-tendencies) which are realized only in specific conditions; they are themselves tendential, i.e. they operate as tendencies only insofar as the social relations in which they are inscribed as emergent properties are 'reproduced-regularized' through a complex web of social practices" (Jessop, 1997: 518).

Also, the important difference between the concept of *totalizing processes* and the concept of a totality, argued to be prevalent in the régulation approach, is addressed by focusing on the micro and macro-economic system. This allows the interrogation of the effects of finance-led growth to emphasize the critical, evolutionary, and dynamic processes of the capitalist system. "Any system of thought that is grounded in the assumption of totalizing processes is evolutionary, historicist, non-teleological and often accepting of eclecticism; a system of thought premised on the assumption that the world 'out there' is a totality, a whole, tends to privilege homeostasis, equilibrium and lack of history"(Palan, 1998a). The concept of political economy advanced by régulationists seeks to incorporate all these variables and, more specifically, apply them to IPE by focusing on the uniqueness of the institution of the state within a global system.

Michel Aglietta's (1979) seminal work of *A theory of capitalist regulation: the US experience*, marks the emergence of the FRS approach and can be arguably considered an attempt to complete Gramsci's initial work on the distinctiveness of American Fordism in re-orienting economic and political systems domestically and globally. Aglietta's (1979) investigation was based on the long-run historical analysis of the US economy as a study of capitalist regulation, it was not an investigation of abstract economic laws, but of the transformation of social relations, "as it creates new forms that are both economic and non-economic, that are organized in structures and themselves reproduced in a determinant structure, the mode of production" (Aglietta, 1979 :16).

This overall analysis formed the foundation of régulation theory; it provided a conceptual framework for understanding processes of capitalist growth, crisis and reproduction. The régulation approach focuses on relationships, largely at the macro-economic and political level, between the process of accumulation and the ensemble of institutional forms and practices which together comprise the mode of social regulation. When a system of accumulation and mode of social regulation are coupled together in a stable fashion they are considered to form, what régulationists term, a *regime of accumulation.* These refer to particular generalizable and regular institutionalized relationships, defined in terms of historical phases and patterns of development, which, in turn, characterized the path of economic growth and define the conditions under which (immanent) crisis tendencies are contained, mediated or at least postponed (Tickell and Peck, 1995: 360).

Beyond simply being able to observe regularized patterns of interaction, régulation theory outlines how the deepening of a regime of accumulation leads to a mode of regulation. This is when the modes of social mediation become so deeply socially engrained as to ensure that the distortions created by the accumulation of capital are kept within limits which are compatible with social cohesion within each nation. This compatibility is always observable in specific contexts at specific historical moments. The salient test for any analysis of the changes that capitalism has undergone is to describe this cohesion in its local manifestations. It also involves understanding why such cohesion is a short lived phenomenon in the life of nations, why the effectiveness of a mode of regulation always wanes. And it requires grasping the processes that occur at times of crisis, confusion and changing behaviour patterns. Lastly, it involves trying to “perceive the seeds of a new mode of regulation in the very midst of the crisis afflicting the old one” (Aglietta, 1998: 44).

Thus, régulation theory is concerned with heterogeneous economic processes in which necessity and contingency, the constraint of the past and the creation of the new are intertwined (Aglietta, 1998). It deals with how processes emerge, are reproduced, and then wither away under the effects of the unequal development inherent in capitalism. Therefore, the regulation approach is related to numerous critical views of the orthodoxy that presents capitalism as a spontaneous development, and progress as the direct and continuous effect of technical development. It affirms the belief that market mechanisms must be supplemented or supplanted by collective action. This action is expressed in the concept of social mediation.

The concept of social mediation mechanisms, in the regulation approach, is seen as intermediary structures that modify the tension between individual interests and capitalist progress. Mediation mechanisms are present in the context of how private actions become generalized forms of interaction. These represent a temporary institutional 'fix', since these interactions do not neutralize crisis tendencies completely. Eventually, the capacity of the social mediation mechanisms to mitigate, accommodate, and absorb competing interests, in particular, and the crisis tendencies, in general, can be exceeded through a process that has been characterized as "institutional exhaustion which causes the regime of accumulation will break down" (Tickell and Peck, 1995: 360).

In short, this whole mediatory structure helps to shape a mode of regulation. The role of mediation mechanisms as a means of accounting for macroeconomic patterns is based on the establishment and pursuit of collective interests. Meaning that the mode of regulation conceptualizes the ways in which the tensions between the expansive forces of capital and the democratic principle have become compatible. This principle has led régulationists to argue that regular macroeconomic patterns based on the accumulation of capital have been made compatible with social cohesion (Aglietta, 1998: 53). This has led régulationists to argue that, in order to understand capitalist reproduction, in its integral sense, it is necessary to understand the wider social and institutional context in which accumulation occurs (Jessop, 1997). This is accomplished through an analytical focus on the nexus of the accumulation process and mode of social regulation. Where a set of codified social relations guide and sustain the accumulation process (Aglietta, 1979:382). These mediation mechanisms can be observed as a complex ensemble of social norms and habits; state forms, structures and practices; customs and networks; and institutionalized compromises, rules of conduct and enforceable laws, the mode of social regulation defines 'the social context in which expanded economic reproduction occurs' (Tickell and Peck, 1995: 361).

It is the combination of a stable regime of accumulation and mode of social regulation that brought about the defining features of post war Fordism. The régulation concept of the 'wage society' (la société salariale) which encapsulates they way "society develops under the impulse of capitalism and in which wage-labour-by far the preponderant form of employment-is also the predominant source of total demand. It follows from this that the compatibility between wage costs and income has to be regulated by social institutions" (Aglietta, 1998: 44).

This concept has often been called the 'wage-compromise' but refers less to explicit wage negotiation but to the degree to which the Keynesian focus on full employment and wages tied to productivity influenced the underlying power relationships within capitalist organization (Clarke, 1988). This is because wages create social division, establishing the power of one social class over another, that power is the power of money. To be more precise, "it is the power of those who have the initiative to create money in order to transform it into a means of funding; it is their power over those whose only access to money is the sale of their capacity to work. This power is exercised with a view to accumulation" (Aglietta, 1998: 47).

Therefore, for régulationists, Fordism was a way of life characterized by the macroeconomic conditions governing accumulation that fundamentally altered the wage-earners conditions of life. The central concept of Fordism, as a regime of accumulation, has developed with the means of production at the centre of the economy alongside the modernization of the consumer goods sector, whose expansion was stimulated by an apparently unprecedented labour-capital compromise based on wages increasing proportionally to gains in productivity. The task of management was to remodel the labour process according to the cannons of scientific management while the concern of unions was to ensure that workers benefited from the corresponding productivity increases. But Fordism was more than simply productivity-based wage increases, as  Gramsci first suggested it changed the fundamental social project of economic growth because it improved workers morality and social integration (Gramsci, 1971).

Included in this analysis was the degree to which consumption, as a series of regularized relationships based on socio-historical norms of expression, was part of the Fordist reproduction of social labour power. Thus, it is not concerned with individual consumer behaviour, but rather with the formation and transformation of the conditions of existence of the working class, in other words, "with the very foundation of capitalist accumulation, the material content of the generalization of the wage relation" (Aglietta 1979:151). This integration of consumption as a process organized around a set of activities, which, while predominately private, are subject to a general logic of reconstitution of energies expanded in social. The nature of consumption process, and its place in institutional forms of social labour-power, is thus as an expenditure of human energy.

While consumption was traditionally conceived of as a predominantly private process; its concrete practices take place principally within the household, a site where individuality is obscured. Because of this consumption is not normally considered in the Marxist tradition as under the direct influence of the relations of production. Alain Lipietz's (1983) attempts to further the cause for understanding mass consumption under Fordism by taking Marxian concepts concerning the fetishizing of commodities seriously by drawing a distinction between an *esoteric* and an *exoteric* economy.

For Lipietz, these two spaces are linked via a vector of exploitation and there is no possibility of withdrawal from one space to another, or of a reduction of values to price (Lipietz, 1983). The exoteric world is that of representations that are necessarily fetishized but efficient. By allowing for the relations of consumption to be considered alongside the conditions of production the régulation approach provides an invaluable social analysis of what made Fordism a unique form of social organization that fundamentally altered the conditions of life for wage-earners.

Thus, the advent of the wage society produced changes in the employer-employee relationship in the first half of the twentieth century allowing for the integration of the labour force into the process of the circulation of wealth produced under the stimulus of capitalism. This integration has established constraints on the accumulation of capital which have given a collective purpose to the pursuit of interests, thereby legitimizing both parts of the dichotomy between individual goals and membership of society. On the one hand, constraints on the accumulation of capital did open up markets created by the integration of the labour force. On the other hand, the subordination of the labour force to the production process has been normalized by the acquisition of social rights giving employees access to the wealth they produce. This historic transformation gives rise to the notion of Fordism as a historically distinct form of the organization of capitalism but also sowed the seed of its own undoing: “the modes of regulation in the wage society are legitimate to the extent that they permit social progress” (Aglietta, 1998: 54).

## 2.3 Crisis of Fordism: From Postfordism to Finance-Led Growth

Regulation theory is concerned with heterogeneous economic processes in which necessity and contingency, the constraint of the past and the creation of the new are intertwined. It deals with processes that emerge, are reproduced, then wither away under the effects of the unequal development inherent in capitalism (MacLeod, 1997). The overwhelming focus of the early literature on Fordism was coming to terms with what brought about twenty years of sustained growth and prosperity and what contributed to its undoing. But, what emerged in the wake of the crisis of Fordism proved harmful to the régulation approach, since the concept of flexible accumulation was never fully substantiated.

In this way, the research on finance-led growth has resolved this internal inconsistency within regulation theory because it showed that the period from mid-1970s to the 1990s was one of contestation, with no regularized forms of economic interaction becoming dominant. What neo-Gramscians would call a ‘corportavist’ period of world order, where no dominant form asserts itself, is consistent with the Régulation School’s inability to properly theorize the scope and nature of change in the aftermath of the demise of Fordist mode of regulation.

The régulation approach has theorized four different levels of crises within capitalist social development. The first is a crisis base on external disruption. For Boyer this is characterised by episodes during which the continued economic reproduction of a given geographic entity is blocked, either due to shortages linked to natural or climatic disasters, or wars (Boyer, 1990: 50). For example, the 1973 crisis often is described as due to oil shocks or dollar shocks. The second is cyclical crisis, which (like Keynes) is considered recurrent but (unlike Keynes) is seen as a consequence of the prevailing institutional forms and may require short term contractions or disciplining of labour or other markets but does not change the overriding institutional form of competition or wage-relation. The third type of structural crisis is within the regime of accumulation, where the social mediation mechanisms associated with different institutional forms are unable to overcome short term tendencies of profit accumulation.

Boyer (1990) outlines three circumstances which may lead to this type of crisis: "external or internal disturbances of a new type that cannot be brought under control within the system of regulation whose structural stability is founded upon responses to other types of problems. Socio-political struggles also threaten existing institutional compromises or the conjunction of individual strategies destroys components of the overall mode of regulation" (Boyer, 1990: 52). The fourth type of crisis is a crisis in the mode of development. This is defined by the limits of the institutional forms and their corresponding social mediation mechanisms that shape the mode of regulation. This means that the most essential economic patterns come into question: "those underlying the organization of production, the time horizon for the valorisation of capital, the distribution of value and the composition of social demand" (Boyer, 1990: 56).

By all accounts 1973 was a significant year in the history of capitalism. The capitalist system, especially in North America and Western Europe, was in a state of crisis: stagflation, rising unemployment and spiralling oil prices forced the advanced capitalist economies into a period of profound social, economic, and political restructuring. What made this crisis of particular significance is that is dealt a fatal blow to the dominant form of capitalist industrialization at the time: Fordism. The régulationists claim its final demise in the early 1970s was brought about not solely by 'external' shocks such as the oil crisis, but also, more importantly, by factors *internal* to Fordism itself, including increasing worker militancy, progressive technological stagnancy and the saturation of consumer markets.

Boyer claims that the 1970s crisis cannot be reduced to either the persistence of equilibrium of underemployment (the usual Keynesian definition) or to the expectation of an imminent collapse of the whole of the system (Marxist vision). Nor can it be reduced to a somewhat atypical business cycle, a viewpoint still current in popular media. The crisis of Fordism was fundamentally a result of the economy's reaching the limits of the previous mode of regulation and the rise of contradictions within it (Boyer, 1990: 13-14). Aglietta (1979) outlines the origins of the crisis of Fordism in terms of its tendency toward creeping inflation, which is a direct assault on financial holdings leading to chronic underinvestment.

Furthermore, Lipietz’s (1983) concept of peripheral Fordism outlines the process by which producers sought to reduce costs by outsourcing production facilities abroad. The combination of increasing inflation and relocation of manufacturing sector to developing companies, alongside the saturation of consumer markets with in industrialized countries, led to a crisis of under consumption. Thus, the collapse of the core institutional forms and social mediation mechanism of the Fordist mode of regulation, namely mass production, wages tied to productivity, and mass consumption, led to a structural crisis and instigated wholesale social and political change.

The régulationists' central point is that regimes will ultimately break down as a result of their rising *internal* contradictions and, moreover, that these contradictions will be manifest in different nation-states in different ways. The observation that national social formations are constituted of specific 'internal' or regional structures, and *at the same time* embedded within particular ‘external’ international relations, does not pose a challenge to this position, but elaborates upon it. Thus, “while the crisis of Fordism was undoubtedly tied up with ‘internal’ causes, such as the productivity slowdown, rising class conflict and technological stagnancy, it was also conditioned strongly by the *geographical* contradictions of the regime of accumulation” (Tickell and Peck, 1995: 374).

The breakup of the Fordist system, since 1973, inaugurated a period of rapid change, flux, and uncertainty. But, whether a new systems of production, characterized by more flexible labour processes and markets, and of geographical mobility and rapid shifts in consumption practices, constituted a new regime of accumulation has been hotly contested. There is always a danger of confusing the transitory and the ephemeral with more fundamental transformations in political and economic life. But the contrasts between the current political and economic practices of today, and those of the post war boom period, are so dramatically different that the initial claim of a from Fordism to ‘flexible’ accumulation seem relevant at the time.

But, the concept of flexible accumulation, as a direct confrontation with the rigidities of Fordism, proved unfruitful in conceptualizing the nature of change in the global political economy and national economic strategies to deal with it. The term ‘flexibility’ referred particularly to changes in the organization of production and its impact on labour processes, labour markets, products, and patterns of consumption. It is characterized by the emergence of entirely new sectors of production, new ways of providing financial services, new markets, and, above all, greatly intensified rates of commercial, technological, and organizational innovation (Harvey, 1990). It has entrained rapid shifts in the patterning of uneven development, both between sectors and between geographical regions, giving rise, for example, to a vast surge in so-called 'service-sector' employment or de-industrialization in the global North. David Harvey (1990) has refers to this process as “a new round of time—space compression in the capitalist world — the time horizons of both private and public decision-making have shrunk, while satellite communication and declining transport costs have made it increasingly possible to spread those decisions immediately over an ever wider and variegated space” (Harvey, 1990: 147).

What remained decidedly missing from this notion of flexibly production was the complete reorganization, and reorientation, of global financial markets and the emergence of greatly enhanced powers of financial coordination. Thus, the concept of flexible accumulation failed to account for the shift towards financial disintermediation and the extraordinary global power of an emergent group of institutional investors; and, on the other hand, a rapid proliferation and decentralization of financial activities and flows through the creation of entirely new financial instruments and markets. Again David Harvey:

Deregulation and financial innovation — both long and complicated processes — had by then become a condition of survival of any world financial centre within a highly integrated global system coordinated through instantaneous telecommunications. The formation of a global stock market, of global commodity (even debt) futures markets, of currency and interest rate swaps, together with an accelerated geographical mobility of funds, meant, for the first time, the formation of a single world market for money and credit supply. (Harvey, 1990: 160-1).

This failure to address the emergence of a new powerful force in the governance of macroeconomic activity led many to claim that the notion of flexible accumulation has greatly exaggerated the significance of any trend towards increased flexibility and geographical mobility, failing to account for how strongly implanted Fordist production systems still are. This inability to reconcile the new forms of social, financial, productive, and state organization proved to be a large gap in the régulation literature. But, the new research on finance-led growth has reconciled these previous criticisms by focusing on how the flexibility achieved in production, labour markets, and consumption was an outcome of the search for financial solutions to the crisis-tendencies of capitalism, rather than the other way round. Admittedly, this new research paradigm did not emerge from a careful consideration of the critiques of the post-Fordism or flexible accumulation, but as an attempt to create a macroeconomic picture of a series of micro-level changes in the organization of markets and actor behaviours within them.

## 2.4 From Finance-Led Growth to Financialisation

Within the field of Political Economy, the recent literature on financialisation has been central to the critical exploration of the myriad transformations occurring within the financial industry and in the relations between the financial sector and other sectors in the economy. While the financialisation literature addresses a broad range of issues, a primary and shared concern here has been the urgent need to re-politicise the activities and competitive strategies of financial institutions and owners of financial assets. In this perspective, the past two decades have been marked by an ever increasing permeation of both the state and civil society by the disciplinary power of global financial markets.

In its most basic form, what makes the financialization literature unique is its accumulation-centred view of economic change, which focuses on where profits are generated in the economy. This is contrasted with the more prominent activity-centred view of economic change, which looks at the composition of the economy and the 'contribution' of different sectors to gross domestic product (GDP)(Krippner, 2005a). Arrighi (1994) defines financialization as a pattern of accumulation in which profit-making occurs increasingly through financial channels rather than through trade and commodity production (Arrighi, 1994).

This definition isolates the degree to which accumulation occurs predominantly through financial activities which, in turn, affects systems of corporate governance to reflect the imperatives of financial markets. Similarly, the social actors located at the privileged sites of financial accumulation accrue new political and economic power. Finally, this conceptualization isolates the impact of the rapid pace of financial innovation indicating the extent to which non-financial firms derive revenues from financial investments as opposed to productive activities (Krippner, 2005a).

The sui generis analysis of specifically financial institutions I take to be the key strength of the recent literature on financialisation (Aitken, 2007; Belfrage, 2008; Epstein, 2005; Erturk et al., 2007; Froud, 2003; Froud et al., 2000b; Froud et al., 2006; Froud, 2002; Grahl, 2009; Harmes, 2001; Konings, 2008a; Krippner, 2005b; Langley, 2008; Montgomerie, 2006a; Montgomerie, 2008; Panitch and Konings, 2008; Seabrooke, 2006; Wigan, 2009). To a significant extent this literature was born of a certain degree of dissatisfaction with the thin depiction of globalizing financial markets in the IPE literature and its lack of specificity about the concrete micro-level institutional frameworks techniques and practices of financial markets. In doing so, it has shown that the contemporary expansion of financial markets cannot be understood as a process of markets disembedding themselves from their institutional context, but that the expansionary tendencies that mark financial markets are produced *in and through* dense and complex institutional networks.

The historical starting point for the emergence of financialisation is the collapse of the Bretton Woods Agreement (BWS) and the subsequent fall from grace of the Keynesian Welfare System (KWS) as the dominant mode of economic governance. The financial services revolution that proceeded the abandonment of BWS, in the early 1970s, was based on the political support for the integration of financial markets into macroeconomic governance priorities, as an antidote to the stagflation experienced during the time. Thus, financialisation is not merely a change in the structure of markets or the increase in the supply of finance, but an inherently political movement that brought together the interests of factions within the banking and financial services industries, governments and central bank policy makers, as well as high income households to address the weakening profitability of the Fordism and to bring an end to elements of Keynesian financial market control.

This means that financialisation is not a static description of the practices of financial markets, rather an entry point of analysis of a dynamic system of social interaction that grows and changes. Thus, finance is not a personality nor is it a structure, but a social construct whose actions are shaped by social forces. Therefore, the concept of financialisation does not see finance as a unit of analysis, nor is it imbued with distinct needs or interests; instead the actions of finance are understood as a product of social forces with an emphasis on the confluence between domestic and global forces. This conceptualization is illustrated in the primary research focus of the financialisation literature, which has focused on interrogating the manifestations of this shift in the organization and motivation of various markets and actors. In particular, the growing importance of: (a) financial market valuation of banks and corporations (credit ratings); (b) public valuation of firms and banks (stock price); (c) asset and risk management; and, (c) innovation in financial instruments.

These four developments have all been directly linked to the advent of 'direct financing' as a primary structural mechanism for generating financial accumulation. Leonard Seabrooke (2001) defined 'direct financing' as the growing disintermediation of banks and investment houses in favour of trading in debt and equity as well as the securitization of receivables, as forming the dominant form of accumulation during the 1990s (Seabrooke, 2001). While Seabrooke has made the case that direct financing is a unique component of the structural power of American finance, régulation scholars have abstracted this to the Anglo-American economies more generally, while the British Social Accountants have preferred to see direct financing as one generic model of capitalist accumulation. Yet, all three have detailed almost identical outcomes in the structure and orientation of economic activity since the advent of direct financing.

First, that direct financing has now privileged financial valuation of creditworthiness, or the surveillance and ranking by credit rating agencies. Aglietta (2000) contends that "capital markets strongly shape corporate behaviour with definite real effects" (Aglietta, 2000: 147)(. Central to the growing importance of financial market valuation has been the move from bank-based and market-based financial systems (for overview see(Grabel, 1996). Bank-based financial systems are characterized by long-run relations between banks and firms, based on trust and a long time horizon.

Market-based systems, on the other hand, exhibit decentralized ownership and relations with short time horizons (Stockhammer, 2004).The growing importance and power of financial information organizations has been able to profoundly affect government policy decisions through evaluation of sovereign bond ratings, directly affecting the state's ability to raise funds on international markets . Similarly, credit rating agencies now one of the leading determiners any bank and firm's viability in the global political economy (Canterbery, 2000; Sinclair, 2005).

Second, financialisation has also impacted corporate management through the diffusion of the logic public valuation. Similar to financial market valuation the key change isolated is the contrast between bank-based on market-based financial systems. This is because financial players, whose influence on corporate managers was so weak as to be negligible in bank-only financial systems, now become prominent influence on corporate governance through a market-based structure. In market-dominated financial systems, the majority shareholder is often an institutional investor exercising direct control through share ownership. Under these circumstances the stock exchange defines the leading benchmarks of profitability, "securities that serve as a reference for indexes representing the generic risk for categories of companies, and the collective opinion of the community of investors works to produce evaluations" (Aglietta and Breton, 2001: 445).

The volatility of such valuations depends on many factors: the flow of new information; beliefs concerning future profits for specific geographical areas or industries; the herd instincts which underlie speculative bubbles; the liquidity of secondary markets; and the rules of management delegation. The financial market as a whole acts to maintain the quality of these benchmarks, which are important because shareholders tend not to focus on the day-to-day movements in the share price of a company, but look instead at such homogeneous financial management indicators as allow them to make a comparison between a specific company's financial profitability and the average rate of return.

The work of Jonathan Nitzan (2001) has extrapolated the consequences of these changes in, what he terms, differential accumulation. The concept of differential accumulation emphasizes the drive of dominant capital groups to beat the average and exceed the normal rate of return, namely through: internal breadth by amalgamation, external breadth through green-field investment, internal depth via cost-cutting, and external depth through stagflation (Nitzan, 2001: 226). For Nitzan this means that capital, itself, is inherently political, moreover, such power processes are seen not auxiliaries to an otherwise 'pure' notion of capital, but rather as essential to its understanding *from the very start* (author's emphasis)(Nitzan, 2001: 229). Other authors like Froud *et al. (Froud et al., 2000a; Froud et al., 2000b)* analyse the discourse of shareholder value and its impact on corporate restructuring. They argue that restructuring in pursuit of the goals set by financial markets is unlikely to meet its objectives of increased profitability, but does have a negative impact on labour. Similarly, Lazonick and O'Sullivan (2000) argue for the USA that there has been a shift in management strategies from 'retain and invest' to 'downsize and distribute'(Lazonick and O'Sullivan, 2000). In both cases, the effects of financial markets on the macro system are seen in terms of profound changes in management strategies.

The concept of shareholder value, in particular, has dominated financialisation literature as they have tried to bridge the gap between the traditional bifurcation of finance from the real economy (Froud, 2000). Alternatively, they have argued that growing pressure to augment dividend returns to shareholders, by increases in share price, shows the degree to which financial accumulation has pervaded both investment and management decisions:

On the side of investors, the necessary conditions are large scale investment in equities and bonds, traded in liquid markets which allow value investors (whether householders or professional fund managers) to exercise choice on the basis of performance as reflected (and constructed) in financial accounting data. From the corporate side, managers must have the power to exercise choice over patterns of merger, acquisition and organizational restructuring in an attempt to meet shareholder requirements; and finally there must be the development of senior management compensation schemes and career hierarchies which reward managers who pursue the interests of shareholders (which may not fully coincide with their own) (Froud, 2002: 127).

Thirdly, asset and risk management by banks, private equity groups, and institutional investors has important ramifications for socio-historical change in the financialisation literature. Based on an accumulation centred approach the concept of financialisation has captured the degree to which financial profit strategies has led to growing plethora of financial instruments, or derivatives, to hedge and bet against portfolio exposure (Toporowski, 2000). For those researching financialisation, the constantly expanding derivatives markets are seen as a consequence of the need to generate revenue from the inherent volatility of financial markets, moving from the locus of profit from *growth* to *change* in market conditions (my emphasis)(Wigan, 2006). The shift from a bank-based to market-based system means the latter is plagued with liquidity fears leading to premature attempts to liquidate efficient investments *ex post*. Since financial systems are rooted in their logics of evaluation, it is important to emphasize the kinds of behaviour these logics entail for financial and non-financial agents and the kind of relationships they imply between finance and the rest of the macro economy (Aglietta and Breton, 2001).

Integrating the combined effects of financial market valuation, public valuation, and risk managements together means that financialisation denotes a new form of competition which involves a change in orientation towards financial results. This new form of competition between financial and non-financial actors illustrated the degree to which concepts of shareholder value or risk management are not mere technical practices, but forces for re-structuring and social change (Froud, 2000). Further, it re-focuses the concept of accumulation-centred interpretation financialisation, where the activities of the market are less meaningful to the problematic of social inquiry than the overall logic of capital accumulation. This new form of competition between the constituent parts of financialisation phenomenon provides a dynamic understanding the imperatives of finance-led growth and how it influences all sectors, not just individual market actors.

The fourth, and final, element of the financialisation literature focuses on the compulsion for financial innovation a primary driver of the expansion of financialisation into ever-increasing areas of social organization. Thus, financial innovation facilitates expansion. Opposed to product market where expansion is based on growth of the firm through investment, the logic of financial accumulation has meant that growth has come primarily through inventing new legal contracts for financial products, thus, recycling pools of finance in a myriad of ways in order to generate more revenue.

For example, the financial innovation of securitization was initially meant to create an asset out of 30-year mortgage obligations, where the receivables were guaranteed over a long period, but recent securitization issues have included unreleased music albums (Elul, 2005).[9] In this sense financial innovation is understood from a dual perspective where innovation has changed the supply of financial services and how the types of financial systems promoted by financialisation have impacted both the strategies of financial and non-financial actors' alike.

## Conclusions - The Geography of Financialisation

The limited purpose of this brief section is to elaborate on one particular aspect of the financialisation narrative as it is commonly represented across this literature; the tendency to view financialisation as a prima facie, internally constituted, Anglo-Saxon transformation. In this narrative, the emergence of powerful structures of financial accumulation in the US and the UK since the 1980s is largely perceived as an internally generated process. The significance of the global political economy for structural transformations occurring at the domestic level is often heavily discounted. The historical prominence of market-based financing, and particularly the rise of institutional investors since the 1970s are often cited as the primary proxy and immediate catalyst for the emergence of the so-called Anglo-Saxon 'equity culture' (Aglietta and Breton, 2001).

As markets for corporate control ascended to dominancy in Anglo-America, both individual firm strategies and overall macroeconomic performance became subject to the discipline of equities and securities markets (Aglietta, 1998, 2000; Froud et al., 2000b; 2001; 2006; Stockhammer, 2004). Simultaneously, households' economic practices and political preferences are brought evermore firmly under the calculative logic of finance, as financial services liberalisation and the resulting explosion in 'financial innovation' facilitates a 'deeper' integration of a growing number of households into the structures of global finance via their dual capacities as asset owners (investors) and (increasingly) as net debtors (Harmes, 1998, 2001; Langley, 2003, 2006; Montgomerie, 2006a; Watson, 2008 ).

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[9] In 1997 rock star David Bowie raised $55 million by selling bonds backed by revenues from his first 25 albums.[1] This was the first application of securitization to intellectual property

To the extent that the global political economy features in this narrative, it is through the hegemonic positions occupied by Wall-Street and London in the global financial markets. Arguably, the dominance of the Anglo-Saxon financial centres has contributed to the spread and dissemination of what are distinctly Anglo-Saxon structural transformations from their 'original heartland' and throughout the developed world. At the same time, we are told, the global spread of structural forms and dynamics created in the US, is itself a decisive aspect of American structural power and continued hegemony (Seabrooke, 2001; 2007).

In this sense also, the financialisation literature follows closely in the footsteps of the French regulation school. For French Regulation theorists, regimes of accumulation are historically and socially specific constructs in so far as that the economic and non-economic institutions and cultural habits which facilitate the reproduction a particular capitalist society can and do vary spatially and temporally. Even so, the bulk of contemporary Regulation literature has been primarily occupied with the Anglo-Saxon experience of finance-led growth. In the wake of WW II the US found itself in a unique position of superiority which allowed it to take the leading role in establishing the institutions of the global political and economic order – the Breton Woods institutions. Consequently the resulting international order not only reflected American interests but also served to further entrench the structural power of the US (Lipietz, 1987; Pijl, 1984).

It is hardly surprising than, that thus far the majority of the financialisation literature has engaged primarily with the Anglo-Saxon experience. By comparison, considerably less attention has been afforded to the financialisation of accumulation patterns throughout the rest of the developed world. In as much as previous efforts to advance this conceptual framework beyond the institutional context of the US and UK do exist, these have tended to accept uncritically the underlying assumptions about the primacy of the Anglo-Saxon experience implicit in this narrative. The resulting research predominately adopted an international comparative perspective, comparing and contrasting trends and developments within different national financial systems, seeking evidence (or lack thereof) for convergence towards the *'original'* transformations of the *'more mature'* Anglo-Saxon financial systems (cf. Jurgens et al., 2000; Morin, 2000; Vitols, 2004b).

Meanwhile, the concentration of international portfolio flows between the affluent economies of the OECD, and the underdevelopment of equity markets in the majority of developing countries, has hitherto rendered the developing world virtually *'invisible'* from the ontological perspective of financialisation (according to IMF's International Financial Statistics, capital flows amongst OECD countries accounted for approximately 80% of total global capital flows in 2005 (cf. Alfaro, 2006; Obstfeld, 2004).

This thesis, does not subscribe to the view that there is something inherently Anglo-Saxon about financialisation. Rather, an investigation into financialisation must adopt as its starting point the borderless character of economic processes. Operating through global markets, financialisation is nevertheless negotiated, assimilated and articulated in qualitatively different manners across different political spaces embedded in the global political economy. Arguably, rather than fostering convergence towards an Anglo-Saxon form of capitalist organization, the particular institutional arrangements supporting the (global) financialisation of accumulation, can and do differ from one (local) economy to another, depending on the spatial and historical specificities unique to different localities within the global economy. In this sense, the argument proposed in this paper falls within the Institutionalist School of political economy (cf. Amable, 2000; Hall and Soskice, 2001; Hay, 2004; Hodgson, 1996, 2004; Hollingsworth, 1998, 2000; Radice, 2000; Screpanti, 1999; Vitols, 2004a; Whitley, 1998; Zysman, 1983). The following chapter aims to take some important first steps in exploring the political and institutional aspects of financialisation in Continental Europe.

# Chapter Three The Financialisation of the European Polity

'The road to the free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism. To make Adam Smith's "simple and natural liberty" compatible with the needs of a human society was a most complicated affair'. (Polanyi, 1944:140)

'… the notion that the market mechanisms themselves initiate the necessary transformation to another model of regulation could turn out to be - in both the West and the East - a frustrating and dangerous illusion' (Altvater, 1993:53).

## Introduction

Since its establishment at Maastricht in 1992, the EU and its constitutive member states have been dedicated to investment-based (supply-side) growth strategies, pursued primarily through regulatory reform of their financial services sectors and labour markets. Over the past decade in particular, since the introduction of Euro and enactment of the Financial Services Action Plan, financial integration and liberalisation has proceeded apace, leading some financial policy experts such as Harvard Professor of Business Rawi Abdelal to conclude that '*the most liberal rules in international finance are those of the European Union'* (Abdelal, 2006:6). It has been as a result of these coordinated initiatives that the regulatory principles and social mediation mechanism of finance-led growth have been regularized in Europe, displacing the now ineffective and out of favour Fordist growth regime and bringing an end to elements of Keynesian demand management.

This state of affairs could hardly be claimed to be the outcome of an organic, or spontaneous, operation of bottom-up market forces in Europe as envisaged by proponents of mainstream neoclassical economics. Nor, for that matter, could it be argued to be the foregone conclusion of an automatic ideological capitulation, or assimilation and convergence, towards more successful US business practices, norms of economic governance and institutional forms, as so often implied in existing International Political Economy literature.

The argument put forward in this chapter, is that this process should be understood as an inherently political movement, facilitated through EU and member state policy, which has brought together the interests of factions within the banking and financial services industries, governments and central bank policy makers, as well as high income households across Europe, to address the weakening profitability of the European economy and reinvigorate its laggard performance, especially when compared to its trans-Atlantic rival.

The previous chapter (Chapter Two) unpacked the concept of financialisation and drawing on the works of Konings (2008a), Cafruny & Ryner (2007b) and Bieling (2006) amongst others presented an approach that conceptualizes institutional variety not by opposing national systems to globalizing financial markets, but precisely by locating them within that process. Financialisation in Europe, it was argued, takes place within the context of a trans-Atlantic political economy. That is to say, The changing imperatives of financial competition are pushing European policy makers, businesses and households to re-orient their strategies around dynamics driven and shaped largely by the globalisation of American finance; in this context globalisation is no longer conceptualised as an external and anonymous process whereby different economic models compete, but rather as the globalisation of concrete practices, strategies and institutional forms developed by American political and business elites. The latter's constitutive role in constructing the structurally biased global financial architecture constrains the autonomy of European policy and business elites.

That said, as Abdelal reminds us, the EU is no fledgling or indebted region, nor a passive victim subject to the disciplinary forces of global financial markets, but in fact an exporter of capital – financier of the world and a primary promoter, and beneficiary of, further financial liberalisation throughout the world. Indeed Abdelal argues further that not only are the most liberal rules of international finance are those of the EU, but, that in turn, European policymakers have been more influential than their American colleagues in pursuing global financial liberalisation through their control over organisations such as the OECD and the IMF (Abdelal, 2006; Abdelal, 2007).

True, the EU regulatory change may conform to US objectives and the EU's regulatory approach substantively similar to the US's – both because of the interpenetration of European economy by US capital and vice versa, and also because of the ongoing transformation of the EU economy itself towards a financially dominated mode of accumulation (Hamilton and Quinlan, 2005). But at the same time the EU is not held captive or subordinated to US interests but rather driven by a European agenda and supported by European agents (public and private) who favour financial liberalization, (such as the Commission, the European Central Bank and transnational financial corporations) and seek further financialisation as a distinctly European interest (Bieling and Jäger, 2009; Bieling, 2003).

Thus, while there is a degree of similarity with US regulatory approach and business strategies, there are also important differences that owe to the particular and specific interests and institutional makeup of Europe. The structural logic notwithstanding, the changing financial imperatives emanating from across the Atlantic do not drive an automatic and unmitigated or mediated process of convergence, institutional flattening or emulation in Europe and the outcomes of Europe's transformation are far from pre-determined. European economic governance and business practices are in fact embedded in a different (and distinctly European) institutional matrix, the transformations of which are subjects to intense political struggle between contending European social interests as was thoroughly documented by Jonathan Story and Ingo Walter for example amongst others (Story and Walter, 1997) .

Rather than driving institutional flattening, or an even pattern of integration, the adoption of Anglo-American financial policies and practices by European states and actors carries unique implications for both economic governance and social development in Europe and works to reshape financial relations within and among different political economies in more nuanced ways. Thus any notion of a pre-determined outcome - Europe turning into Anglo-Saxon Europe needs to be dispelled.

Instead, this chapter seeks to remedy the inherent structural determinism evident in both the mainstream and critical approaches to the financialisation of the European polity and recover the agency and constitutive role of European policy elites in pursuing financialisation as a competitive strategy of accumulation. Through examining the actual policy measures and agenda of financial regulation pursued by the EU since the 1990s, the chapter aims not only to re-politicise the increasingly technical discourse of financial regulation in the Europe, but crucially, also to demonstrate the existence and relevance of a particular European approach towards financial regulation, or in other words, the existence of a distinct form of European financialisation.

Concretely, this chapter argues that much like the restructuring of European growth strategies in line with the exigencies of the Fordist regime of accumulation in the wake of World War II, financialisation in Europe has been pursued through a top-down, interventionist policy agenda which itself is fundamentally rooted in and inseparable from, the political process of European Integration. To the extent that the European financial system has, in certain respects, developed towards an Anglo-American liberal structure, it has done so by relying on institutional forms inherited from an age old tradition of state-led capitalism in continental Europe.

Indeed the initiating role of state power in social development has long been a feature of continental European states as described by various economic historians, (e.g. Gerschenkron, 1966) and one which, I argue, has carried over into the European integration process itself since its inception. Trans-Atlantic rivalry along the way has further engendered and contributed to reproducing a set of distinctly 'European' attitudes and interests, also in the financial sphere, as is becoming increasingly evident by the on-going public disjuncture between European and US policy makers during and in the wake of the financial crisis of 2007-2010 (see for example FT 8.11.2007; FT 16.11.2008; FT 14.03.2009; FT 22.09.2009; FT 30.03.2010; FT 30.09.2010; FT 11.11.2010).

In attempting to gauge the distinct trajectory of European financialisation, the chapter is organised as follows: the First Section provides a historical account of the initial wave of European integration in the immediate aftermath of World War II. This was premised around notions of Keynesian-Fordist regime of accumulation. Far from representing a liberal agenda intended on creating a smooth sphere of liberal governance, Fordism was deployed in Europe in a top-down fashion as part of a broader catching-up agenda and a means of resisting the further expansion of Anglo-Saxon practices of economic governance in what Alan Milward termed 'the European Rescue of the Nation-State' (Milward, 2000 [1992]).

Section Two then examines the so called neoliberal turn embodied in the Single European Act of 1986 and the Maastricht Treaty of 1992. These formative documents would establish the foundations for re-launch of the European project, premised this time around post-Fordist strategies and patterns of accumulation, in which the financial sector would take the central role. Finally, Section Three further examines the finance-led restructuring of the European polity since the introduction of the Euro, and the corresponding efforts to establish a common financial market through the policy agenda which came to be known as the Financial Services Action Plan (FSAP).

## 3.1 Post War European Integration and the Fordist Regime of Accumulation

The political project of European integration originally articulated the pooling and coordination of state functions required to adjust to, and facilitate, the transnationalisation of capital. This was deemed necessary, given the circumstances prevailing in 1945, when the strongest European state lay prostrate between the English-speaking West and the Soviet Union and its bloc in the East. The pooling was seen in the creation of a European supranational structure, locking West Germany's industrial resurgence into a 'European' framework with real regulatory powers.

Coordination was witnessed in the emergence of a civil-legal European space in which transnational capital could be liberalised along 'Lockean' lines (Van Der Pijl, 2011 Forthcoming). This in turn allowed for peaceful, negotiated redistribution within various economic spheres-of-influence without engendering political friction, and thus suspending the political effects of uneven development that early 20th-century theories of imperialism had pinpointed as the cause of war (Lenin, 1969).

The prevailing view in the West was that only through this pooling and coordination could internal conflict be prevented, and the common stand against the Soviet bloc maintained. Thus, European integration was motivated by a desire, not just to reconstruct Western Europe as Milward maintains (1994), but to restructure it, in the transnational context of the North Atlantic political economy. Key economic statesmen like Paul Hoffman and Jean Monnet considered this a precondition for developing an alternative to socialist aspirations and potential Soviet influence while at the same time this strategy was meant to compensate for the prior capture of the commanding heights of the global economy by the anglophone West. (Hoffman quoted in Carew, 1987:8; Marjolin, 1989:212).

Continental Europe however, was ill-prepared for such a re-configuration of forces in 1945. After three wars with Germany, the French were determined to also create the specific structures of redistribution which would allow them to gain a measure of control over their potential rival. In 1949-50, Monnet and his associates in the French state and state planning structures developed a strategy to lock West German industrial resurgence into a 'European' framework with real regulatory powers. An organised European economy might then consolidate the temporary advantages that planned modernisation was yielding in France, or at least allow peaceful, negotiated redistribution—as the trans-Atlantic English-speaking world had made possible on the basis of liberalism and the rule of law[10]. The Federal Republic, in turn, was willing to reciprocate French 'European' initiatives as a way of regaining sovereignty and economic strength (Dinan, 2004, 2006).

In turn, European industrialization and growth strategies followed the pattern initially developed in the United States, under President Roosevelt's New Deal Programmes during the 1930s (Van Der Pijl, 1984: chapter 6). The European productivist growth regime was to be similarly based on the nexus of mass production and mass consumption of consumer durables, made coherent by a capital-labour wage compromise (Burawoy, 1985; Maier, 1987).

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[10] A transnational, self-regulating sphere of capital accumulation was historically first developed in the context of the British Empire. It survived the breakaway of the United States; once the US and Britain (as a silent partner) had jointly committed themselves to liberalism in the Americas under the Monroe Doctrine of 1823, British surplus capital poured into the United States, and after the Civil War began financing railways, industrialisation, and corporate consolidation (Pijl in Albritton 2001:7).

This compromise assured the relative stability of income distribution by indexing wage increases to productivity growth, which in turn assured sufficient aggregate demand (Aglietta, 1979; Armstrong et al., 1984). Economic and social governance were premised on national, Keynesian demand management by states to keep mass production going and an accompanying 'social safety net' in the form of the welfare state (Jessop, 1997).

The Marshall Plan, announced in June 1947, was intended to kick-start a transformation in European industrialization and growth strategies. It was intended to create a demarcated space for re-liberalisation by integrating trade and payments among fifteen countries. The scope of integration was drastically scaled down to six however, when the French government resisting US influence proposed a European Coal and Steel Community (ECSC) in May 1950. The ECSC, the first 'European' institution, assumed superordinate control of the coal and steel industries of its six member states.

By creating a structure for price and investment controls, effectively subjugating steel production and prices to the needs of a nascent mass production industry, it was hoped that the iron and steel industry would become part of a configuration that would supply the steel-using industries at competitive prices, and facilitate the momentum for a Fordist mass production economy (for which equipment was being delivered under the Marshall Plan) to take off (Van Der Pijl, 2011 Forthcoming). This has been done even while an automobile industry, or consumer goods industries more generally, did not yet truly exist in Europe – but in an attempt to launch them. Indeed the shifting of state-owned military production capacity compensated for the limited civilian car production industry in the beginning and formed the basis for its subsequent growth.

The coordination of the steel industry's investment plans, and (some) control of prices, worked also to create a level of policy-making through which a transnational class interest could consolidate. This transnational class would take precedence over traditional state classes increasingly constraint by newly introduced democratic controls. The High Authority, a federalist institution was less important than the parallel European Court of Justice, because the Court pointed in the direction of a transnational legal space.

The discipline of capital here could be enforced by court actions initiated by plaintiffs suffering from market imperfections or infringements of anti-cartel law, rather than by a political institution (Pijl, 2006:41) But this was not a foregone conclusion, and the existence of two parallel lines of development was the real constitutive feature of the subsequent integration process.

The European Economic Community, (EEC) established in 1958 by the Treaty of Rome, was arguably the quintessential manifestation of Ruggie's so-called 'embedded liberalism' (Ruggie, 1982). Drawing on Polanyi's problematisation of the disintegration of society due to socially disembedded economic processes (Polanyi, 1944), the notion of embedded liberalism suggests the attempt to mobilise community in a way that is confluent with liberal capitalist accumulation. Accordingly, the EEC aimed at supplementing national Keynesian policies in fostering growth through the liberal pursuit of a common, integrated market, which would allow manufacturing firms to realize the gains associated with economies of scale.

Thus, the political impetus for the initial project of European integration was not merely post-war reconstruction, or even to foster economic interdependence as a force for future continental peace as is often portrayed. The original drive for European integration, as well as its governance strategies and institutional features, cannot be abstracted from the historically specific European industrial-led accumulation regime in which it emerged; European policy elites sought to and succeeded in, effecting a state-led fundamental re-orientation and restructuring of European growth strategies and patterns of accumulation along Fordist principles of economic governance.

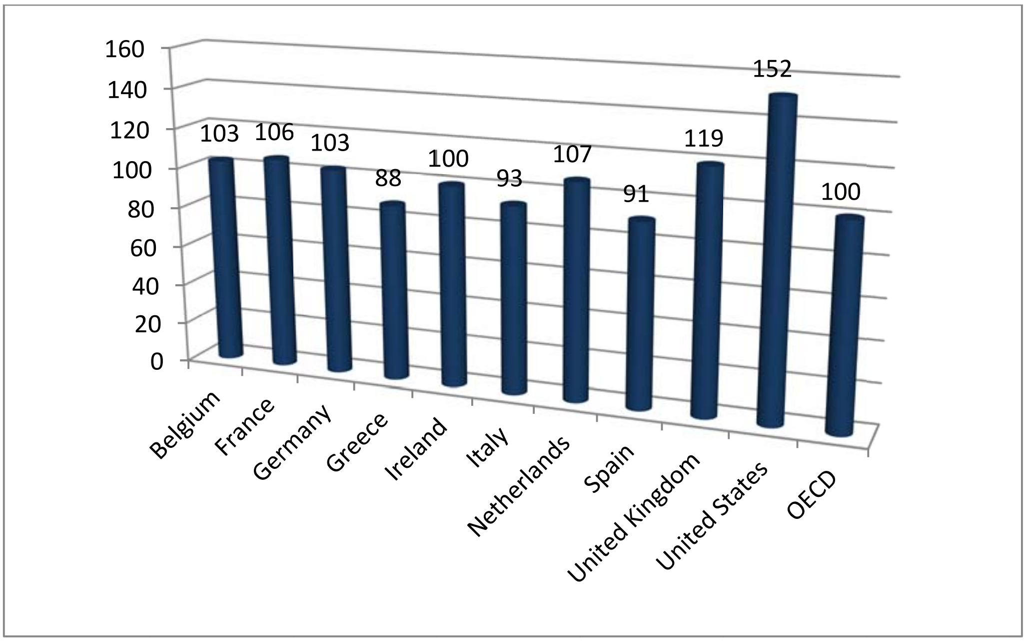
Crucially, though this regime assimilated key aspects of the industrial growth model that developed endogenously in the United States, it was established not as an unbridled submission to US hegemony, but as a renewed strategy of contention (Calleo, 1976; Milward, 2000 [1992]; Rupert, 1995; Van der Pijl, 2006a). From its very inception, Fordism assumed a distinctive or hybridized form in the European context and there were key differences in the social impetus and developmental imperatives of the US and European models of Fordism.

In the United States, this accumulation regime arose organically, out of a class compromise generated by tensions within the sphere of the market. US trade unions fought a protracted battle, not only against industry, but against the state itself, in pursuit of this compromise (Maier, 1977). In Europe by contrast, this compromise was driven by social democratic political parties, who, through their control of state apparatuses, predominantly through the mechanisms of the welfare state, were able to engineer the concertation of industry and labour, abetting the development of a mass consumer society in order to drive economic expansion (Maier, 1987). The details vary of course from one individual country to another, but by and large European states took a more active role than the US, In effect, jump-starting a Fordist regime of accumulation in a top-down fashion.

Thus while European policy elites sought to strategically emulate the more successful practices and strategies developed within the US corporate sector, the emulation was never complete, nor did it bring about total convergence with every day (micro) practices or systemic (macro) features of the US economy. Rather, the restructuring of the European economy came up against exiting institutional characteristics of European systems, the result of which were different from the Anglo-Saxon experience in many important ways.

Most notably perhaps the fiscal burden of European states – an outcome of the aforementioned role of the state in facilitating class compromise and social reproduction became evident in the 1970s (Clarke, 1988; Offe and Keane, 1984; Olson, 1982). Secondly European societies never fully developed a consumer society along Anglo-Saxon lines. This meant that European mass production, to be successful largely depended on export led growth. To this day domestic consumption in the US is more than one and half times the OECD average while the major continental European countries hover around the OECD average (Figure 3.1). Thus, Fordism in Europe depended on the US in more than one way; as a market of first resort as well as through the US role in the monetary system for example.

Figure 3.1 - Actual Individual Consumption - PPP Real per head (% of OECD average, 2005)




Source:(OECD, National Accounts Database, November 21st 2007. Available Online: www.oecd/dataoecd/53/47/39653689.pdf).

And yet, though Western Europe was pursuing strategies originating in the US, it had not abandoned its long legacy of state-led capitalism. The continued penchant for rationalistic top-down planning within European Fordism maintained a rift in the North Atlantic political economy, which is also crucial for understanding the distinctive development of European financialisation. Echoing the origination of Fordism in Europe, and unlike the more spontaneous generation of neoliberal financialisation in Anglo-Saxon countries brought on by the disintegration of the class compromise with the crisis of Fordism in the early 1970s, European financialisation involved the directing hand of the state. Financialisation in Europe, it is argued in the following sections, was deployed as a top-down catch-up strategy.

## 3.2 The Neoliberal Turn in European Integration

No-one is forcing the European Union to become more competitive than the United States in nine years time. But if that is what we really want, we must leave the comfortable surroundings of the Rhineland and move closer to the tougher conditions and colder climate of the Anglo-Saxon form of capitalism, where the rewards are greater but the risks also. If we spurn the means we must lower our sights lest we lose credibility and become ridiculous. So we must force ourselves to carry out those micro-economic supply side structural adjustments we decided upon in Lisbon. Single Market Commissioner Bolkestein (2001) quoted in (Bieling, 2006:431).

The crisis of productivity and consequent stagflation which plagued the transatlantic Fordist economies during the 1970s, aptly referred to as 'Eurosclerosis' (Giersch, 1985), signalled the unravelling of the structural, institutional and ideological foundations not only of the Fordist growth regime, but also of the European integration project constructed around it (Scharpf, 1981, 1991; Tsoukalis, 1985). In Germany, annual growth rates of 4.4% between the years 1964-1973 fell to 2.9% in the period 1973-1979, and to 1.5% over 1979-1987 (Rosser and Rosser, 2004:240). In France, a growth rate of 4.0 % for the period 1960-1973, fell to 1.7% over 1973-1979, and remained at this rate until 1990 (Crafts and Toniolo, 1996:10). For two decades the ambitions of European integration stagnated, as its legitimacy was undermined by faltering economic performance. The prospects for further economic integration critically hinged on the ability of European elites to present a coherent vision for progressive reform to address the weakening profitability of the Fordist growth regime (Bieler and Morton, 2001c; Eichengreen, 2007; Tsoukalis, 2005).

The 1980s saw the beginning of the introduction of neoliberal principles of privatisation and market deregulation across Western Europe. With Western European states facing mounting budget deficits and growing inflation, Keynesian demand management became decreasingly sustainable (Clarke, 1988; Garrett and Weingast, 1993; Scharpf and Schmidt, 2000). In no case was the change towards balanced budgets and strong currency clearer than in France. Following the election of Mitterrand's left unity government in 1980, there was an initial attempt at a Keynesian policy, complete with import controls (Lipietz, 1983, 1987). In 1983, this policy was abandoned in a move that greatly appealed to private industry (Tsoukalis, 1997; Van Apeldoorn, 2002).

It was this strategic shift which would become the basis of a re-invigorated European project, with Mitterrand's minister of finance and economy, Jacques Delors, move to Brussels as president of the European Commission two years later (Sutton, 2004). In 1986 the Single European Act (SEA) prepared by the Delors Commission established the goal of completing the Single European Market by removing restrictions on the transnational movement of labour and crucially, of capital. When the SEA was adopted in 1987 it represented the first effort to amend the foundational treaties of the European Communities and re-launch European integration after almost two decades of stagnation, with the aim of extending the internal market to allow the free movement of labour, services and critically, of capital (Abdelal, 2006; Abdelal, 2007; Bieling, 2006; Tickell, 1999).

The reconceptualization of European integration around the tenets of privatisation and deregulation, though, retained the core political objectives of post-war integration. Specifically, the concern was one of maintaining the subordination of the German economy to the European regulatory framework. This framework allowed member nations to check a potentially destabilising German political and economic resurgence, which threatened to destabilise European integration as a viable catching-up strategy (Van Der Pijl, 2011 Forthcoming).

The Franco-German balancing act is also crucial in understanding the move towards the Economic and Monetary Union EMU). In 1988, the French were successful in outlining the conditions for monetary integration, through the European Exchange Rate Mechanism (ERM). This was aimed at curtailing the tendency of German monetary policy to dominate the policy of other states in the volatile post Bretton Woods exchange rate environment (Grauwe, 1988; Sutton, 2004:238). Édouard Balladur, France's Minister of Economy and Finance had put forward the idea of a single currency and a European Central Bank (ECB), seen as a way of providing a more equitable representation of monetary policy within Europe. In Germany, the Foreign Minister Genscher supported the idea of EMU despite the inevitable loss of autonomy this would entail for the Bundesbank, because of the greater protection it would ensure against the vicissitudes of the US dollar (Notermans, 2001:29).

The Treaty of Maastricht, was ratified by the member states in 1993. It secured the path towards EMU, and formally ensconced the framework for neoliberal convergence (setting inflation targets and introducing constraints on national budget deficit levels) as the basis for any further integration. The Growth and Stability Pact (GSP) adopted by the European Council in 1997 further entrenched these goals and also consolidated the role of European institutions in monitoring and enforcing national monetary and fiscal compliance with the targets set forth in Maastricht.  The GSP vitiated the remaining vestiges of demand management with its highly restrictive fiscal and debt prescriptions, with members of the Eurozone limited to budget deficits of 3% of their GDP, and government debt capped at 60% of this amount. The prescribed penalty for states failing to adhere to these GSP restrictions were having to deposit 2% of their state's GDP with the European Commission, without any interest in return.

Thus, the renewed legitimacy of the European idea coalesced around a coherent vision for the institutional redesign and strategic reorientation of the European polity, in line with neoliberal principles of economic governance premised around notions of investment-led growth. Most importantly, the EU facilitated the increasing depoliticisation of the national economic sphere, removing key aspects of policy formation from state authorities accountable to local constituents. In this manner, the neoliberal agenda became entrenched at a level of EU policy-making. Ideally this meant that policy making was kept safely out of the reach of national political systems, except for governments and selected pressure groups. At this level, effectively removed from public scrutiny, the neoliberal principles of economic policy and social organisation have successfully maintained their hegemonic position.

Thus the de-politicisation of economics, rather than political integration, became unifying driving force of this supranational regulatory-state (Cooper, 2000:38). By the mid-1990s Neoliberalism had become inscribed in the thinking and practice of European institutions. The discourse of an ominous globalisation has further helped to naturalise neoliberalism as the only viable solution to Europe's lingering economic problems (Bieler, 2000).This limited the space for legitimate dissent also by its encapsulation as a technical matter, and neoliberal orthodoxy as professional competence.

The following quote by a key policy maker is representative of the reigning attitude at the EU level:

The market-led process should be seen as the predominant driving force towards further integration… …Most importantly, it should be determined by the market, once regulatory and other obstacles have been removed. Public authorities have, of course, to play their role, but it is really up to the market to grasp the opportunities provided by the regulatory framework and competition policy (Speech by Padoa-Schioppa, 2004, Member of the Executive Board of the European Central Bank, Berlin, 22 March 2004).

Critics of the EU neoliberal agenda have concluded from this and other comparable statements that 'the leading political and economic forces in Europe present neoliberalism as a taboo that cannot be violated'. (Milios, 2005:209). By equating neoliberal convergence with the goal of enhancing the economic, monetary and political unity among EU member states the neoliberal strategy is effectively exempted from criticism and placed out of reach for 'any substantial revision or change' (Ibid). The process of European integration itself thus becomes a mechanism of imposing and observing neoliberal discipline; the deepening and broadening of integration is a vehicle of conversion to neoliberalism.

Neoliberalism thus became the political ideology underlying financialisation as a strategy of accumulation. Duménil and Lévy assert that *'Most, if not all, analysts on the left now agree that 'neoliberalism' is the ideological expression of the reassertion of the power of finance....'* (2005:17). The neoliberal commitment to price stability, (at the expense of other socio-economic policy goals such as full employment, etc.) unfettered capital mobility and critically, the deregulation of the financial services industry, became frequently cited as the primary regulatory harbingers of the growing political and economic power of global finance (Epstein, 2005; Helleiner, 1994).

But as an ongoing hegemonic project, the EU has often moved to absorb and deflect political antagonism, careful not to be over-rigorous in the application of neo-liberal discipline. Evidencing this was the lack of enforcement of punitive measures entailed by GSP. The EU did contemplate taking action against Portugal when it fell afoul of the rules in 2001, but the spectacle of Germany, France, Italy, and the UK (albeit not an EMU member) amongst others all consistently failing to meet the EMU requirements, (see table 3.2 below) made disciplinary action self-defeating, and punitive measures were suspended; in 2005 the EU Council 'relaxed the GSP requirements, albeit without renouncing the GSP itself.

**Table 3.2 - Member States –SGP Compliance**

| Annual Government Budget Deficit (% GDP) | | | | | Gross Government debt (% GDP) | | | |
|---|---|---|---|---|---|---|---|---|
| Reference value | min. -3% | | | | max.60% | | | |
| | 2001 | 2002 | 2003 | 2004 | 2001 | 2002 | 2003 | 2004 |
| Austria | 0.2 | -0.2 | -1.1 | -1.1 | 67.1 | 66.6 | 65 | 65.5 |
| Belgium | 0.5 | 0.1 | 0.2 | -0.5 | 108.1 | 105.8 | 100.5 | 97.4 |
| Denmark | 3.1 | 1.7 | 1.5 | 1.1 | 47.8 | 47.2 | 45 | 42.3 |
| Finland | 5.2 | 4.3 | 2.3 | 2.0 | 43.9 | 42.6 | 45.3 | 44.5 |
| France | -1.5 | -3.2 | -4.1 | -3.7 | 56.8 | 58.6 | 63 | 64.6 |
| Germanv | -2.8 | -3.5 | -3.9 | -3.6 | 59.4 | 60.8 | 64.2 | 65.6 |
| Greece | -1.4 | -1.4 | -3.0 | -3.2 | 107.0 | 104.9 | 101 | 97.0 |
| Ireland | 1.1 | -0.2 | 0.2 | -0.8 | 36.1 | 32.3 | 32 | 32.4 |
| Italy | -2.6 | -2.3 | -2.4 | -3.2 | 110.6 | 108.0 | 106.2 | 106.0 |
| Luxembourg | 6.3 | 2.7 | -0.1 | -2.0 | 5.5 | 5.7 | 4.9 | 4.5 |
| Netherlands | 0.0 | -1.9 | -3.2 | -3.5 | 52.9 | 52.6 | 54.S | 56.3 |
| Portugal | -4.4 | -2.7 | -2.8 | -3.4 | 55.6 | 58.1 | 59.4 | 60.7 |
| Spain | -0.4 | 0.0 | 0.3 | 0.4 | 57.5 | 54.6 | 50.8 | 48.0 |
| Sweden | 2.8 | 0.0 | 0.7 | 0.2 | 54.4 | 52.6 | 51.9 | 51.8 |
| UK | 0.7 | -1.6 | -3.2 | -2.8 | 38.9 | 38.5 | 39.9 | 40.1 |
| Euro area | -1.6 | -2.3 | -2.7 | -2.7 | 69.4 | 69.2 | 70.4 | 70.9 |
| EU15 | -1.0 | -2.0 | -2.6 | -2.6 | 63.2 | 62.5 | 64 | 64.2 |

Source: (European, Commission, Economic & Financial Affairs, Public Finances in EMU Reports) Available online:

http://ec.europa.eu/economy_finance/publications/european_economy/public_finances_emu_en.htm

This is also evident with the ongoing war of attrition to impose the European Constitution, which Cafruny and Ryner describe as a 'quintessentially neoliberal and Atlanticist document'. 'Unlike normal constitutions, which define institutions and enshrine fundamental rights, it elucidates the principle of "a highly competitive market economy"' (Cafruny and Ryner, 2007b:4). This is a prime example of what Steven Gill referred to as new Constitutionalism, underpinning disciplinary neoliberalism (Gill, 1998). The attempt to 'lock in' neoliberal policy into the integration process at this juncture however suffered a defeat at the hands of voters in France and the Netherlands in 2005. However, even if we accept the claim that this vote provided the first chance for a real public debate about the neoliberal nature of integration since Maastricht, it has not itself suspended the neoliberal principles on which the EU is run (Van der Pijl, 2006b).

We only have to look to the successor to the European Constitution, the Treaty of Lisbon, which has been thrust on the voters of Ireland for a second time to see that the commitment to financially driven accumulation has not been abdicated. Even the onset of the current global financial crisis that broke in 2007 is unlikely to produce the type of seismic shift away from the neoliberal mode of economic governance in the EU. If anything, the ongoing crisis has provided an opportune means of ransoming the Republic of Ireland and other vulnerable member states into consent.

## 3.3 Building European Finance Led Growth

Addressing a panel of financial regulators at a UN sponsored conference in New York in 2005, Mr. Joaquín Almunia, European Commissioner for Economic and Monetary Affairs stated that:

"The economic motivation for financial integration reflects a two-step rationale. In the first step, financial integration is expected to promote financial development. In the second step, improvements in financial development should result in higher output potential in the real economy...

…On this basis, the European economy – and by extension the people of Europe – have much to gain from financial integration. Not surprisingly, therefore, financial integration is a key element of the EU strategy for economic reform...

…In addressing the challenge of financial integration, EU policymakers are conscious of the fact that integration cannot be an end in itself. The objective is to raise the performance of the EU economy and, in so doing, the living standards of the people. For this reason, the financial integration process should not be seen in isolation. Instead, it is an integral part of an effort to implement broader economic reform. And, the success of this broader reform effort will depend crucially on a successful completion of the single market for financial services".

(Almunia, 2005)

So far I have argued that the European project took a neoliberal turn in the 1980s. however still in the late 1990s, it was perceived by policy makers (as the quote above suggests) and academics alike that economic growth in Europe was below its potential, and lagging behind the United States (Duménil G. and Lévy, 2005; Dunford, 2005). At this point pursuing further financial integration was perceived as the way forward. As Tickell documents, the financial sector had been neglected for most of the European Commission's existence. Now it was upgraded to the most important sector, with the promotion of competition and the harmonization of regulation placed at the top of the Commission's agenda (Tickell, 1999:63). Financial integration came to be seen as the primary lever for broader economic growth. In the course of the 1990s, with the creation of the Eurozone, and the dismantling of independent European central banks, a new regime of accumulation started to take shape.

From 1998, the EU agenda became increasingly dominated by an emphasis on financial deregulation, as embodied by the Financial Services Action Plan (FSAP) (Bieling, 2006; Grahl and Teague, 2005; Reszat, 2005; Verdun, 2000). The FSAP first surfaced in October 1998 as a few brief paragraphs in a Commission document ordered by EU leaders at their June 1998 Cardiff European Summit chaired by Tony Blair, entitled Financial Services: Building a framework for action.

‘The Council… …invites the Commission to table a framework for action by the time of the Vienna European Council to improve the single market in financial services, in particular examining the effectiveness of implementation of current legislation and identifying weaknesses which may require amending legislation;’

Presidency Conclusions - Cardiff, 15 and 16 June 1998 SN 150/1/98 REV 1 Pp. 9. Available Online: http://www.europarl.europa.eu/summits/car1_en.htm

The Commission's communication document responding to the Council’s request was delivered later that year, singling out the need to reform and upgrade EU legislation that, at that point, had failed to deliver a single financial market. Change was urgently needed. The euro's introduction was a few weeks away. The EU's economic performance compared unfavourably with the US, where the latest academic studies ascribed America's superior growth to its market-based financial system.

‘…The structural improvements to the European economy that will result from a genuine single financial market will maximise both the direct and indirect contribution to longterm growth, competitiveness and jobs.… …Efficient and transparent financial markets also help to optimise the allocation of capital. By facilitating the access to equity financing and risk capital, they allow SMEs and start-up companies to fully exploit their growth and job creation potential… …However, compared to the situation in other industrialised countries, the EU financial services sector is still lagging behind.’

Financial Services: Building a Framework for Action Communication from the Commission. COM (98) 625, 28.10.1998, Available Online: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/fs_en.pdf

In December that year, at the Vienna Council meeting of the European council the Commission’s communication was adopted and the commission was given the go ahead on the Financial Services Action Plan:

‘51. The European Council stresses the importance of the financial services sector as a motor for growth and job-creation, but also the challenges due to the introduction of the single currency. It therefore welcomes the Commission's initiative for a framework for action and the establishment of a High-Level Group. It asks for a Council report to the European Council in Cologne on the necessary steps towards a single financial market...’ EU Presidency conclusions – Vienna 11 and 12 December 1998, Available Online: http://www.europarl.europa.eu/summits/wie1_en.htm#3

The Plan articulated the central aim of public action to remove legal, regulatory, supervisory, and tax obstacles to further financial integration. The underlying assumption was that further financial integration was mainly impeded by existing member state national laws and regulations, and that integration had to be pursued by removing legal barriers to operations across borders. In their Lisbon 2000 Summit, the Council identified the FSAP as being a ‘prerequisite for the attainment of the EU’s economic potential’ and as such, an integral part of what has come to be known as the 'Lisbon Agenda', a plan to make the EU 'the most dynamic, innovative, knowledge-based economy in the world by 2010' (Financial Services Action Plan EurActiv Policy Summary, 18.12.2004. Available Online: http://www.euractiv.com/en/financial-services/financial-services-action-plan/article-132874)

The FSAP set out 42 action points, split into three categories: 1) promoting the emergence of a common European wholesale market for corporate and public securities, currently pursued in the context of the Markets in Financial Instruments Directive (MiFID); 2) removing barriers to cross-border retail transactions, based on the principle of the ‘Single European Passport’, which allows financial service providers licensed in any member state to offer services in all others on the basis of 'maximum harmonisation' which, amongst other things, places more emphasis on home state supervision (as opposed to the 'minimum harmonisation' approach, which previously characterized EU financial services legislation); and 3) establishing an efficient supervisory and regulatory regime, primarily in the fields of corporate governance and taxation (Financial Service Policy Group 1999).

The processes set in motion in the 1990s with FSAP to advance financial integration have come to fruition by 2005 when all FSAP regulatory targets have been achieved on schedule. This unusual accomplishment of EU legislation was achieved predominantly due to the application of a particular legislative procedure designed specifically and exclusively for financial regulation. In July 2000, Baron Alexandre Lamfalussy, heading the so-called 'Committee of Wise Men', was tasked to identify 'how the urgent integration of financial services regulation could best be approached' (Financial Services Action Plan EurActiv Policy Summary, 18.12.2004. Available Online: http://www.euractiv.com/en/financial-services/financial-services-action-plan/article-132874). Out of this committee arose the Lamfalussy process, which became the procedural basis for the FSAP legislation in the fields of securities trading, and was subsequently expanded also to banking and insurance.

Essentially, the Lamfalussy process involves breaking down the decision making process into four levels. In Level 1 the key political aims are to be formulated by the Commission, and adopted and ratified by the EU Council and EU parliament respectively. The 'technical' details of implementation are than relegated to the EU Commission which in consultation with sector-specific national and European regulatory bodies decides on appropriate measures, while coordination between national regulators and compliance and enforcement are addressed in Levels 3 and 4 respectively (Reszat, 2005).

Overall, the Lamfalussy process, as the Commission reports, was intended to make Community legislation on security markets more flexible and adaptable to financial innovation. While firmly rooted in the EU's long-standing tradition of 'comitology', is itself an innovative mode of governance, originally developed in the context of financial integration and regulation to tackle the 'urgent need for integration in the fields of securities trading, banking and insurance in Europe' (Financial Services Action Plan EurActiv Policy Summary, 18.12.2004. Available Online: http://www.euractiv.com/en/financial-services/financial-services-action-plan/article-132874).

In this drive for innovation, a significant aspect of financial regulation within the EU, though, was being 'depoliticised'. FSAP and the Lamfalussy process were effectively removing financial regulation from the regulatory control of the publicly elected representatives in the EU Parliament and the nationally elected members of the European Council. In a rather innocuous sounding tone, the process '*established a rigorous mechanism whereby the Commission seeks, ex-ante, the views of market participants and end-users (companies, investors and consumers) by way of early, broad and systematic consultation…'* (European Commission staff working document SEC (2004) 1459 Brussels, 15.11.2004, Available Online: http://ec.europa.eu/internal_market/securities/docs/lamfalussy/sec-2004-1459_en.pdf).

On January 31st 2007, the national authorities in the EU 25 adopted the technical implementing measures (Level 2), implementing Directive 2004/39/EC, commonly known as the Markets in Financial Instruments Directive (MiFID). MiFID represents the most significant piece of regulation to date to be adopted under the Lamfalussy process. In the words of Internal Market Commissioner Charlie McCreevy, (June 2006) MiFID seeks to promote a *"…more integrated, deeper and efficient capital market, which Europe needs to lower the cost of capital, generate growth and boost its international competitiveness"*. MIFID will allow financial service providers to market their services across the EU based on their home country regulations, in turn placing increased competitive pressure on national regulators.

The MiFID contains detailed rules on most aspects of capital markets and has effectively harmonized regulation across the EU. The liberty of national authorities to impose local rules on foreign operators was removed under MiFID and a single passport in securities markets is now within reach. For all practical purposes, EU securities markets are now-governed by a single, EU-level rule set. The directive's most sweeping reform is the abolition of the so-called concentration rule. It means that EU member states will no longer be able to require investment firms to route orders exclusively through stock exchanges. This is a policy measure aimed at promoting disintermediation – a key aspect of financialisation (Wigan, 2009). Exchanges will then face competition from electronic trading systems and investment banks that now routinely cross clients' buy and sell orders in-house instead of putting them through a regulated exchange.

MiFID brings about significant restructuring of the European financial landscape. It l harmonizes the existing diversity of national financial regulatory environments and thus, promotes convergence in market practices within the EU. MiFID aims explicitly to push EU financial markets to move further in the direction of the Anglo-Saxon model of dis-intermediated financing by creating a European equivalent to the US shadow banking system (dark liquidity pools for example) facilitating market access for new financial challengers such as hedge funds and others and tipping the balance of power further in favour of institutional investors. However since its implementation it has been the big continental European banking champions (like German Deutsche Bank and BNP, Italian Unicredit and French Societe Generale) who emerged as the big winners of MiFID, (Mugge, 2010).

Likewise the jury is also still out on whether MiFID is likely to generate consolidation or fragmentation in the European financial services market which is currently dominated by 2-3 big exchange platforms which account for an overwhelming majority of liquidity in Europe (Porter, 2005) MiFID will surely act as a lever for wider economic and social reform transcending the financial sector itself but the question remains whether MiFID will generate a more efficient allocation of capital or alternatively will result in a crowding out of physical investment in favour of financial investment thus ending up detrimental to long term economic growth of the EU.

Beyond the economic ramifications of MiFID lies something more significant; it is nothing less than the culmination of a new governance strategy, envisioned in the 1990s, that places the integration of financial services in the driving seat of the single European market. As a consequence of its adoption, the political agency of non-state actors has been greatly enhanced and institutionalized, at the expense of representative democratic forms of policy-making. It is safe to assume that MiFID's impact will inevitably spill-over into the core areas of the European project, affecting social cohesion and economic disparities across the EU.

MiFID represents shifts in political and economic power relations between financial capital (rentier) and productive capital that are distinctly European. The transformations in capitalist accumulation strategies resulting from MiFID will be institutionally and idiosyncratically shaped by the spatial and historical specificities unique to the EU. Thus, recognizing the distinct contours of an emerging European form of a financialised growth regime is thus valuable in itself. It is further essential to understanding the rationale and dynamics of the political and economic integration in Europe and its socioeconomic outcomes.

## Conclusions

Clearly, as can be seen, the EU has not been any less committed to investment-based growth strategies than its Anglo-Saxon counterparts. Financial services and labour markets in the EU have been subject to similar regulatory reforms to the ones implemented across the Atlantic. Consequently, in Europe, like in the US and the UK the structural power of financial capital has been on the rise, mostly as a result of EU policies. Arguably, the case for interpreting this as essentially a political movement is even stronger than in the US, given that the EU is a pluralistic political polity, comprised of 25 sovereign states.

In particular, the aims of the Financial Services Action Plan were in sum, rather than in terms of the detailed prescriptions, relatively straightforward. In addition to the aim of financial market integration, the plan envisaged a substantive restructuring of European finance. This restructuring would centre on the co-extension of disintermediation and market-based financing. Europe’s financial markets would catch up via a shift to state-of-the-art risk management and a greater reliance on the recently minted techniques of portfolio optimisation and structured finance. The promise, in line with the neoclassically derived economic vision of European integration, was a more efficient allocation of capital, wherein credit would flow to where it could be best used and borrowers would obtain funding at optimal (cheaper) rates.

It is to the consequences of this top-down political agenda that we now turn in Chapter Four.

# Chapter Four Trends in the European financial system after FSAP

## Introduction

Since the announcement of the FSAP in 1999, and even more so since the European economy began to recover from the dot com bubble in 2003, a rejuvenated European financial system seems to have woken from a long period in hibernation. The Financial Services Action Plan, discussed in the previous chapter, catalysed an era of unprecedented dynamism and rapid transformation of the European financial industry which was stymied only with the advent of the global financial crisis in the summer of 2007. This dynamism and accelerated change has occurred both in the macro landscape of the European financial sector and at the level of its micro foundations; European finance has emerged on one hand at the aggregate level in the image of its US rival, and on the other hand, at the level of its individual constituents, expanding via specific strategies and business models.

The data at the macro level are unequivocal. Statistics on market capitalisation and depth, financial and real-estate asset prices, macroeconomic leverage ratios and aggregate bank profitability, or the share of financially accrued income in the GNP, reveals similar trends to the ones witnessed across the Atlantic (Epstein and Jayadev, 2005). Indeed, one might be too easily led to believe that indeed Europe has been following in the path now so well-trodden by the US and the UK and that convergence towards an Anglo-Saxon mode of financial capitalism was inevitable. However, a more thorough examination of the micro foundations of these transformations (at the level of households and individual bank's business model and strategy for instance), uncovers some crucial differences between the US and European trajectories of financialisation. We need to look through the aggregate picture to ascertain the specificity of a financialised Europe.

In this chapter I will undertake to account for the similarities as well as the differences between the US and European experience by locating the causes for the micro divergence and macro convergence in the institutional specificities and path-dependent developments of these two respective financial systems. My thesis is that the character of European financialisation therefore cannot simply be read off from an aggregate resemblance to that of the US, since it mode of insertion into a global financial competition has been particular, and lent European financiaisation its peculiarities.

The chapter proceeds in four sections. Section 4.1 identifies macro trends and aggregate data, which verifies the quantitative maturation of European finance. This section therefore provides the empirical basis for arguing that since the launching of the Lisbon Agenda Europe has indeed been undergoing processes of financialisation in a way that in aggregate at least, somewhat superficially resembles the same processes of financialisation that have previously occurred in the United States. However, the chapter continues in arguing that this picture masks historical and institutional European specificity, which occludes any universalising, or unidirectional account of financialisation. Section 4.2 therefore proceeds by deconstructing this aggregate image and identifying the key institutional modalities, or the European institutional specificities, which connect the wide array of micro practices to these macro level changes. Section 4.3 shows how banking strategy in Europe, though of course not uniform, has been consequently transformed and evaluates the systemic cohesion, or institutional complementarities of the still nascent, yet rapidly unfolding process of European financialisation. Section 4.4 concludes

## 4.1 Macro Trends in European Financialisation

The literature on financial crises has demonstrated that almost all major crises have been preceded by a combination of two correlated phenomena: an unusual increase in asset prices and a corresponding n increase in leverage (or credit expansion)(Bello et al., 2000; Bonner and Wiggin, 2006; Galbraith, 1997; Kindleberger, 2001; Nesvetailova, 2007). As will be demonstrated below, these two alarm signals could be observed not only in the US but in Europe as well as early as 2005/6. Yet, unfortunately, they were largely ignored by policy makers on both sides of the Atlantic. Contrary to widespread perception, Europe accumulated more imbalances than the US. It is instructive to look more closely at both indicators of impending financial instability in Europe separately: a) credit expansion (or leverage) and b) the asset price appreciation.

### 4.1.1 Leverage

Financial leverage increases when credit expands, but prices for goods and services remain stable so that nominal GDP does not increase. A high level of leverage is an essential ingredient in any major financial crisis because it means that many agents have issued promises to pay a certain nominal amount but do not necessarily have the ‘expected’ regular cash flow to honour these promises (see Minsky, 1970 ; 2008 for the classical description of leverage schemes leading to systemic financial instability). Since regular cash flows will be proportional to GDP, macroeconomic leverage can be measured by relating the stock of credit to GDP. It is not possible to establish an absolute benchmark for leverage, as different financial systems can support quite different ratios of credit to GDP. However, changes over time, especially rapid increases in this ratio, constitute alarm signals, which have been identified as reliable predictors of financial crisis(Nesvetailova, 2007).

The increase in overall leverage in Europe, measured by the debt-to-GDP ratio, was broadly comparable to the one experienced in the US; only its distribution over different sectors was different. Table 4.1 below shows these stylised facts. A first key observation is that the increase in overall (economy-wide) leverage has always been higher in the Euro Area (EA) than in the US. The increase between 1999 and (end) 2007 was around 100% of GDP for the EA, while in the US it amounted to 80% of GDP.

Similarly leverage in the nonfinancial corporate sector increased by 25% of GDP, 1999 to end 2007 in the EA, whereas in the US the increase was only 3%. The most notable differences between the US and the euro area are in the leverage of households and the financial sectors respectively. Leverage increased considerably in the US household sector (40% of GDP) but increased very little in the euro area. In contrast, financial sector leverage is at a much higher level in the Euro Area and increased by much more (about 70% of GDP compared to 40% in the US).

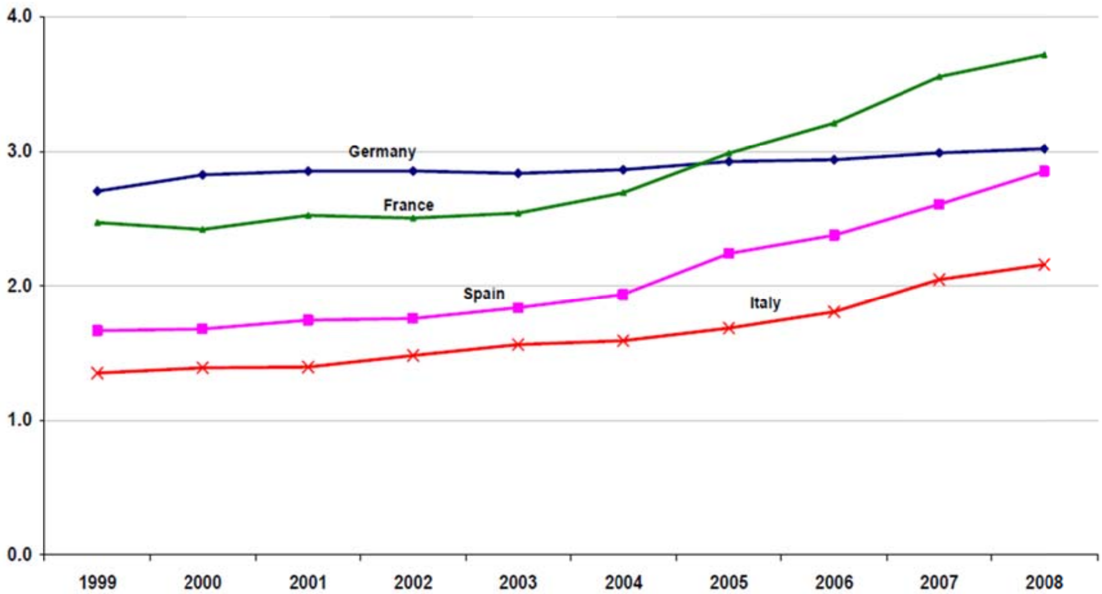
Table 4.1 Debt-to-GDP ratios

| | a) Economy-wide | | b) Non-financial corporate sector | | c) Financial sector | | d) Households & small business | |
|---|---|---|---|---|---|---|---|---|
| | EA | US | EA | US | EA | US | EA | US |
| **1999** | 3.51 | 2.66 | 0.67 | 0.46 | 1.61 | 0.79 | 0.48 | 0.88 |
| **2007** | 4.54 | 3.47 | 0.92 | 0.49 | 2.32 | 1.17 | 0.61 | 1.28 |
| **2008** | 4.73 | 3.46 | 0.97 | 0.49 | 2.42 | 1.17 | 0.61 | 1.24 |
| **Change 1999-2007** | 1.03 | 0.81 | 0.25 | 0.03 | 0.71 | 0.38 | 0.13 | 0.4 |

*Source*: Centre for European Policy Studies Policy Brief 194/16 July 2009. Pp. 2. *Notes*: Economy-wide includes households, non-financial companies, the financial sector and government. Debt is the sum of securities and loans by the non-financial sector and banks or non-monetary financial institutions (MFIs). The financial sector in the EA is defined as MFIs, insurance corporations and pension funds and other financial intermediaries including financial auxiliaries. MFIs' debt is given by debt securities issued plus currency and deposits. *Sources*: Centre for European Policy Studies Policy Brief 194/16 July 2009

Looking at aggregate data on credit expansion therefore yields the conclusion that the European economy is by no means 'less financialised' than the US economy, if anything the financial sector in Europe arguably plays a more significant role for the wider economy than in the US. Credit to GDP ratios of all but one sector in the economy (the household sector) have been higher in Europe already in 1999 when the FSAP was launched, and have subsequently, 'outperformed' the US since then. It is important to note at this point however, that aggregative indicators can often mask a great degree of internal variation, and this is certainly the case here. As figure 4.2 below shows, the evolution of credit growth (as measured by MFI assets relative to GDP) was high, but stable in Germany, whereas it increased considerably in other Euro Area countries such as France and Spain for example. The differences between the various European national economies, as well as between Europe and the US in terms of sources and recipients of credit growth will be explored in more detail later in this chapter.

**Figure 4.2 Total MFIs' Liabilities Excluding Capital & Reserves (%GDP)**

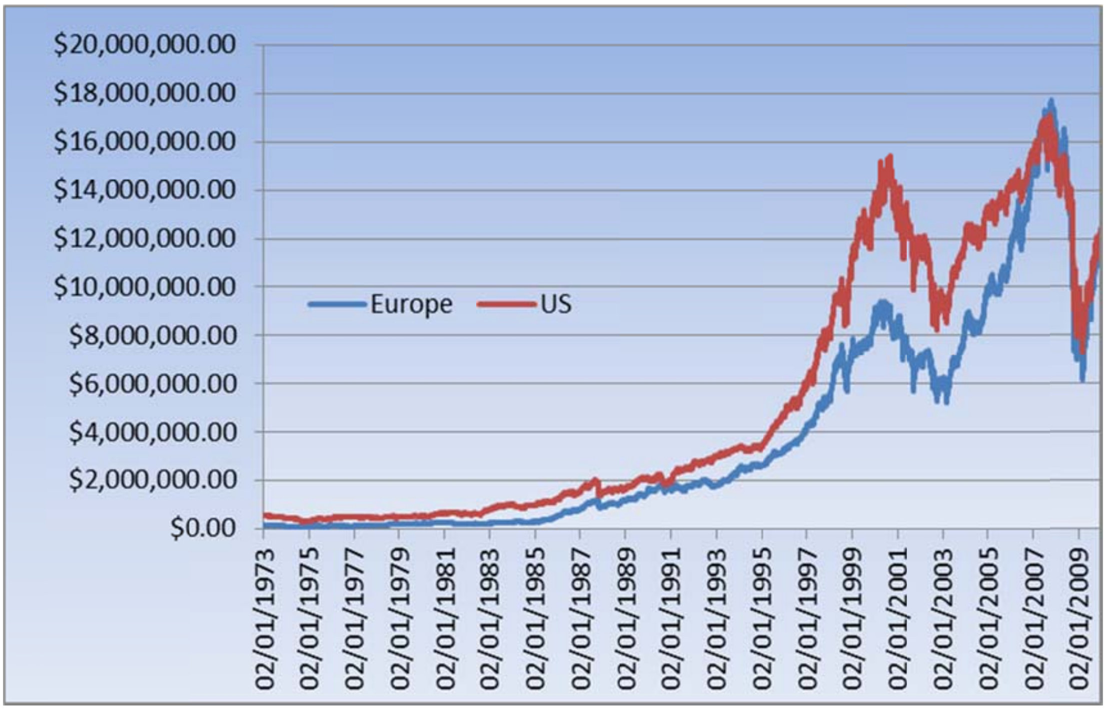



*Sources*: ECB Statistical data Warehouse, MFIs' accounts. Available online: http://sdw.ecb.europa.eu/browse.do?node=2018827

### 4.1.2 Asset Prices

In late March 2007, at the eve of the global financial crisis, a remarkable watershed was passed, one, which only a short while earlier would have been deemed implausible. Reported extensively in the Financial Times and other financial media outlets, according to Thomson Reuters DataStream, the world's most comprehensive financial statistical database, The value, or market capitalisation of European equity markets surpassed that of the United States (cf. Authers, 2 April 2007). Europe's 24 stock markets, (including those of the UK, Russia, emerging Europe and Turkey) saw their market capitalisation rise to an unprecedented $15,720bn (€11,819bn). Meanwhile, the value of the US equity market by comparison according to the same source stood at $15,640bn[11].

**Figure 4.3 - Thomson Reuters Datastream Indices Europe/US Market Capitalisation (US$)**



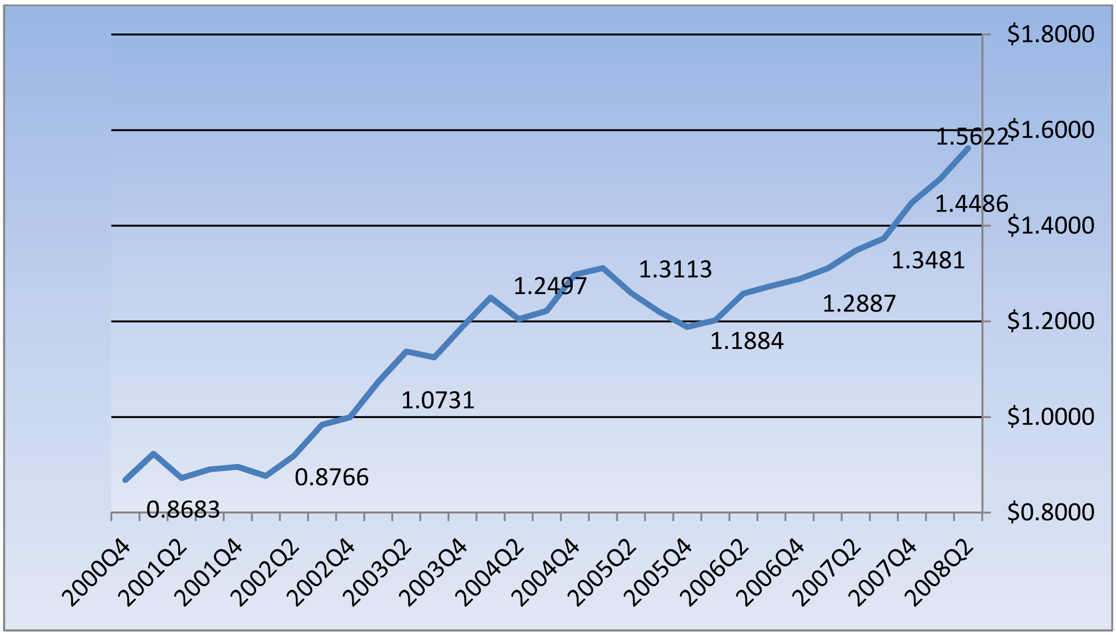

Source: compiled from the Thomson Reuters Datastream (Thomson Reuters, Datastream Accessed through the London School of Economics Library on 03.03.2011).

[11] Europe's equity markets' capitalisation continued to rise thereafter, peaking at just over $16,773bn in early June of 2007, whereupon financial markets on both sides of the Atlantic capitulated to the then called 'subprime mortgage crises'.

On this, perhaps the most popular measure of financial maturity or financialisation, Europe had overtaken its trans-Atlantic rival. European equity indices have, in fact outperformed the US equity indices in dollar terms since the start of 2003. Spurred by improving corporate profitability and further aided by Euro appreciation at a magnitude of 26 percent (see figure 4.4 below), market capitalisation in Europe rose by 160 percent, compared with a 70.5 percent rise for the US stock market (own calculations based on original data from Thomson Reuters Datastream - see figure 4.3 above).

On this level at least, the geopolitical cartography of financial power seemed to be reverting to a long past pattern. The all too often deployed metaphor of a 'seismic shift' seemed appropriate here. After all, the last time Europe had occupied such a position of ascendancy had been prior to World War I (Feis, 1930). On this gauge alone the rise of European equity was a indeed shift of historic proportion.

**Figure 4.4 Euro-USD Quarterly Exchange Rate**




Source: Compiled from Eurostat Quarterly Bilateral Exchange Rates dataset

There are certain equivocations, however which should temper our perception of this historic shift. First, the definition of "Europe" is one that economists, market analysts, or even geographers would not normally recognise. It covers all of "emerging Europe" – including Turkey and Russia and stretches the vision of Europe into Siberia and Anatolia. By crossing the Urals, "Europe" includes Russia's fuel reserves. By crossing the Bosphorus, it gains the Turkish economy, at the time growing at more than 6 percent annually. The population of this "Europe" is about 2.5 times that of the US. North America, including Canada and Mexico, indeed might be a better comparison.

Secondly, while Thomson Reuters Datastream indices clearly show this watershed, the FTSE and MSCI indices, more widely used by international investors, do not. The MSCI indices, for example, showed the US equity market capitalisation as 37 percent higher than Europe for the same dates (see figure 4.5 below). This is because the Thomson Financial Datastream does not adjust for the size of free floats, unlike FTSE and MSCI who have a reduced or no weighting to shares that cannot be freely traded such as holdings of governments or controlling family shareholders. Europe has many more companies with such stakes. Arguably, the Thomson Reuters Datastream indices better captures underlying value, while the MSCI and FTSE better represent the reality facing investors (Authers, 2 April 2007).

**Figure 4.5 - MSI Indices Europe/US Market Capitalisation (US$)**

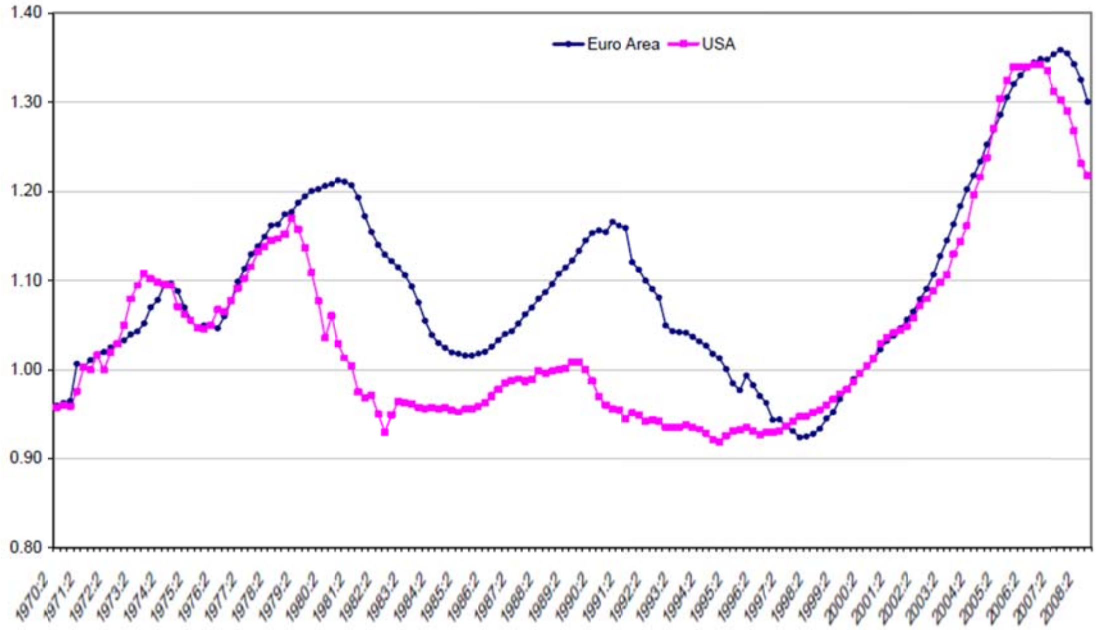

Source: compiled from the Worldscope database, (available on Thomson Reuters, Datastream Accessed through the London School of Economics Library on 03.03.2011)

This gap between the Datastream and MSCI/FTSE indices indicates an important characteristic of the institutional and organisational specificity of European financialisation, namely that the increasing significance of markets for corporate control in Europe has been achieved in the context of structures of corporate ownership that are still markedly different than in the US – more concentrated and often reliant on minority state holdings and therefore presumably less susceptible to the disciplinary influence of institutional investors active in financial markets. We shall return to revisit this issue in more detail in the following discussion of the micro foundations of European financialisation.

It is also true that since the spring of 2007 some of these factors have been proven fleeting by the advent of the global financial crisis of 2007-onwards, however the shift in corporate culture in Europe is still telling nevertheless. For decades, through boom and bust, US companies were more focused on shareholder value, and delivered far higher returns on equity than their European counterparts. European financial restructuring has seemingly turned the tables round. Equity markets, the pinnacle and quintessential institution of Anglo-Saxon financialisation have grown exponentially in Europe, reaching levels, which for many had been consigned to history. At the outset of the new century (and prior to the global financial crisis of 2007-onwards), Europe's stock markets appeared firmly on course to regain the preeminent position that they had once occupied at the outset of the previous century. Thus, these aforementioned caveats in no way negate the secular and significant trend captured by the Datastream indices. On this, more inclusive quantitative gauge, the elevation of Europe's equity markets to a preeminent global position is an undeniable fact.

Meanwhile real-estate prices in Europe have also similarly experienced massive and rapid appreciation of a comparable magnitude to the US markets. Figure 4.6 below shows this using the ratio of house prices to rents which (like the price/earnings ratio for stocks) should be stable over longer periods. It is apparent that since the mid-1990s house prices have increased by almost exactly the same relative amount, reaching an unprecedented level on both sides of the Atlantic. The main difference between the US and the euro area is only that since 2006-07 house prices have declined more in the US.

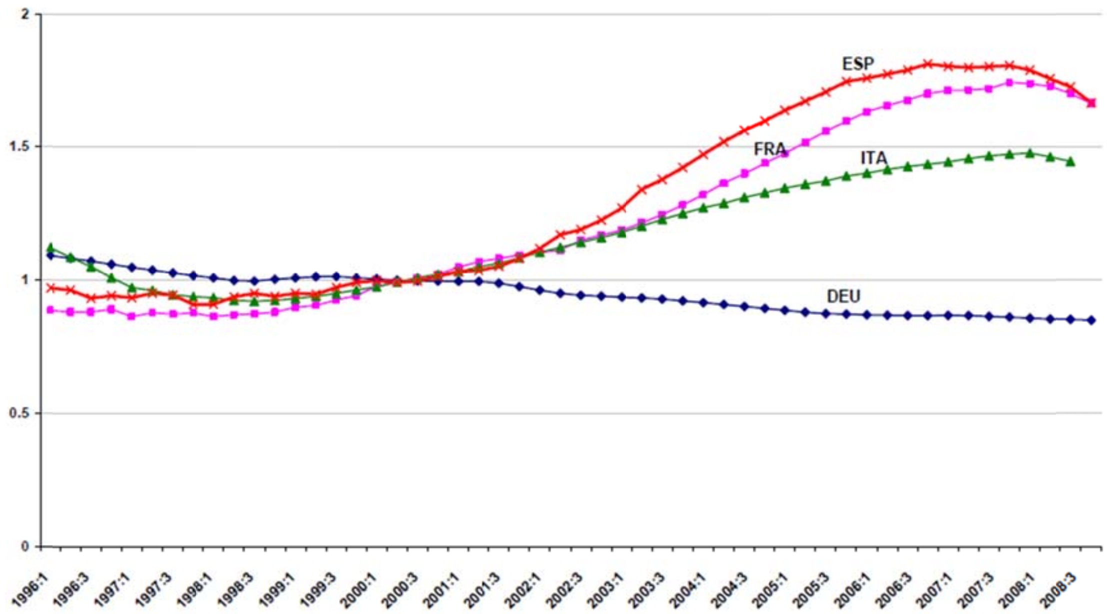
**Figure 4.6 House Price/Rent Ratios – EA—US**




*Source*: Centre for European Policy Studies Policy Brief 194/16 July 2009. Pp. 3. *Note*: Euro area index is defined as the weighted average (by GDP) of Germany, France, Italy, Spain, Finland, Ireland and the Netherlands.

An examination of the aggregate data on asset price appreciation in Europe leads to a similar conclusion to the one reached by looking at leverage ratios. European financial assets as well as residential real-estate have been subject to the same patterns of rapid appreciation as across the Atlantic, an in many cases even to a greater extent. However, once again, these are aggregative measurements, focusing on the Eurozone average, and thus concealing enormous differences in terms of the evolution of financial and real-estate prices across the continent (Calza et al., 2009). As Figure 4.7 below illustrates, the German housing market for example has been stable since the mid-1990s while France and Spain on the other hand experienced house price rises in the magnitude of over 80%, (thus, more than in the US (Gros, 2009).

**Figure 4.7 House Price/Rent Ratios – Euro Area Members**




*Source*: Centre for European Policy Studies Policy Brief 194/16 July 2009. Pp. 4. *Note*: Euro area index is defined as the weighted average (by GDP) of Germany, France, Italy, Spain, Finland, Ireland and the Netherlands.

In summary, while at an aggregate, or macro level the European economies seem to be hot in pursuit on the trail of their trans-Atlantic rival towards evermore increasing financialisation of patterns of accumulation, already it is obvious that the institutional, organisational and even cultural infrastructure, which is supporting these developments in Europe is markedly different than in the US. In fact even amongst the European economies themselves institutional specificity is playing an all important role in shaping the strategies of various market participants/sectors as well as determining their outcomes. It is to the explanation of these diverging micro foundations of financialisation in Europe that this chapter now turns.

## 4.2 The Origins of European Institutional Specificity

While the policy framework adopted by European policy makers followed in the steps of the US policy framework, European financial institutions are embedded in a different and specific institutional setting. To elucidate this specificity, it is necessary to trace the trajectory of European financialisation. Albeit dynamic, institutions are always historical and for clues as to the differing nature and specificity of the institutional constitution of European finance it is necessary to first turn to historical institutional paths. While institutions are historically confined, that is institutions display a level of path dependence, they are at the same time adaptive. In consequence, this argument asserts the specificity of European finance through an understanding of the independent volitional force of European path dependence.

The trajectory of European financialisation is markedly distinct and it is to the origins of this distinction that the argument now turns. This argument relies upon, first, the differing ways in which individuals were positioned in relation to the financial systems, and thus wider social systems, of the US and Europe, and second, the particular features of banking structures in the United States and Europe.

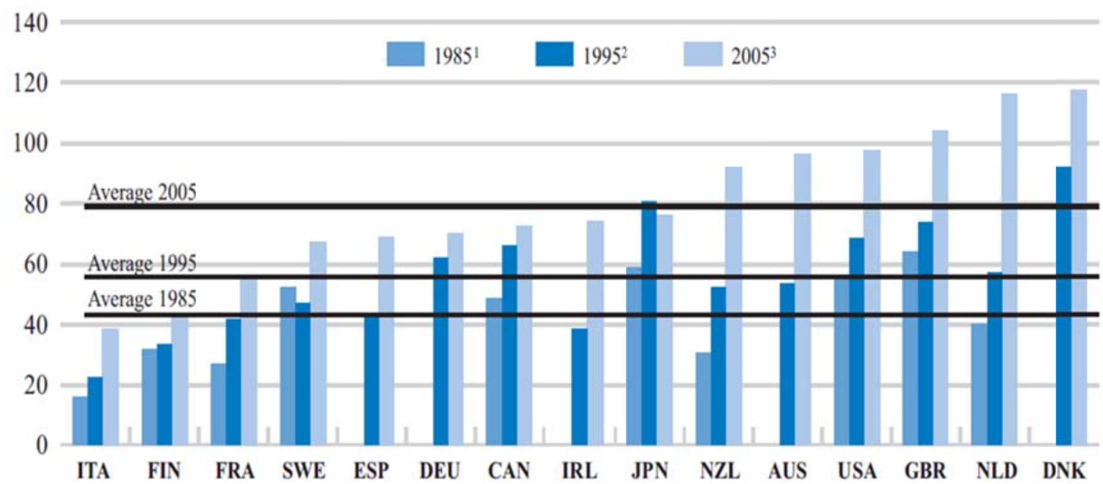
### 4.2.1 The European Household Sector

The comparative low level of aggregate household sector leverage identified in the previous section suggests that here is a major departure of the European form of financialisation from the US path. Indeed, crucially, the integration of the European household sector (and particularly the middle-class) into the financial system has been overall sluggish and in some cases very limited. This stands in stark contrast to the situation in the United States, where the household sector was integrated into the financial system already under the strictures of Fordism and during the rise of mass consumption. Put simply, the Fordist compromise in the United States was conducted to a larger degree through market mechanisms. Three clear illustrations of this lie in the early emergence of the consumer credit industry in the United States, the reliance of household savers on equity returns (predominantly for old-age provisioning), and broad-based access to highly leveraged mortgage finance in the US (Aitken, 2005; Harmes, 2001; Langley, 2006; Montgomerie, 2006a; Montgomerie, 2008; Seabrooke, 2006).

In continental Europe, on the other hand, demand management and class compromise was primarily facilitated by the tripartite corporatist structure of industrial relations, the concomitant wage compromise, a commitment to full employment that rested on Keynesian demand management, and redistribution through relatively well developed and universal welfare systems (albeit to varying degrees in different national contexts) (Belfrage, 2008; Esping-Andersen, 1990; Glyn, 2006; Hancke et al., 2007; Schwartz and Seabrooke, 2008). Due to these interdependent factors, the European household sector was never fully integrated into the financial system in quite the same direct manner in which this integration occurred in the United States.

Figures 4.8 below detailing household indebtedness demonstrate the resulting low level of household integration into the financial system in European economies via a focus on household borrowing patterns across continental Europe. What is however perhaps most immediately apparent from figure 4.8 are the unevenness and internal differences between EU states. In Denmark and in the Netherlands for example, household credit approaches 120 percent of GDP in 2004, higher than in the US and UK, while in Italy it is below 40 percent, precluding for all intents and purposes the possibility of talking about a single monolithic European trajectory of household financialisation while at the same time highlighting the significance of institutional specificity.

**Figure 4.8 – Household Debt (%GDP)**

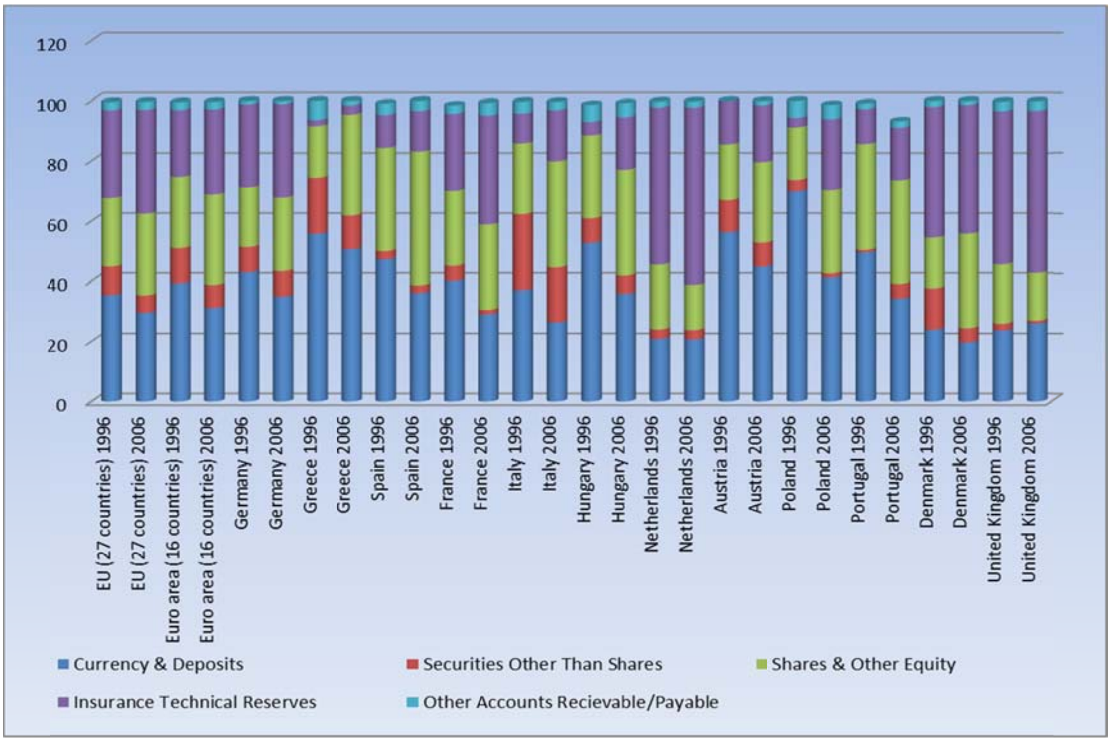



source: (OECD, 2006)

Notes: 1987 for UK; 1999 for Ireland; 2004 for Japan, Denmark & Spain.

Focusing on household saving and investment patterns yields a somewhat similar story. For private households, the long-term trend of declining interest rates made savings deposits in bank accounts less attractive as an asset class. Instead, in many European countries, retail savers increasingly turn to direct market investing in order to secure their financial futures, and the reliance of savers in what is somewhat disparagingly termed 'old Europe' upon bank deposits and concomitant stable but, in times of asset price increases, relatively low returns has partially dissolved. In the Euro Area on average, the share of bank deposits shrank from 40% in 1996 to 31% one decade later, while equity climbed from 23% to 30% and insurance reserves from 22% to 28%[12] (see Figure 4.9 below). Thus the European saver is gradually becoming the active investor so long recognised as a central feature of the financial landscape in the United States.

**Figure 4.9 – Household's Stock of Financial Assets by Instrument 1996 and 2006 (% of Total Financial Assets)**




Source: Own calculations based on Eurostat Annual National Sector Accounts

[12] The role of the insurance sector in Europe calls for some comment. In most European countries, insurers are the largest institutional investors, and changes in their investment behaviour, such as focusing more on unit-linked contracts that enable investment risk to be transferred the policyholder, rather than the traditional guaranteed-return contracts, where the risk is retained by the insurer carry significant effects for financial markets 2007, Institutional investors, global savings and asset allocation, in: C. o. t. G. F. System, ed. (Bank for International Settlements, Basel).

### 4.2.2 The European Banking Sector

An equally volitional distinction lies in the respective banking traditions in the United States and Europe. Perhaps the most significant regulation guiding the development of the US financial system towards market-based finance was the 1933 Banking Act (also known as the Glass Steagall Act).[13] The aim of the Glass Steagall Act was to make banking safer and less prone to speculation as a direct reaction to the economic problems, which followed the Stock Market Crash of 1929 (Gardner, 1964). The provisions included in the Act separated the activities of commercial banks and securities firms and prohibited commercial banks from owning brokerages. It also prohibited paying interest on commercial demand deposits and capped the interest rate on savings deposits. In effect, this legislation (along with the poor state of the banking sector during the 1930s), created a kind of 'capital vacuum' in the American financial system (Panitch and Konings, 2008).

First, the impact of this regulatory constellation was that investment banks in the US, cut off from funding from a deposit base were forced to rely upon capital markets for investment purposes. The strictures on the activities of both commercial and investment banks in the US had the further effect of encouraging the emergence of a host of specialist agents in the financial markets ranging from broker dealers and asset managers to hedge funds (the so-called (‘shadow banking system’)(Roubini and Uzan, 2005). This void was also quickly seized by the ascendance of institutional investors in the US (Harmes, 2001; Konings, 2008b).

One of the key elements contributing to the rise of institutional investors in the US (and directly relating to first point of difference from continental Europe, i.e. the integration of the US middle class into the circuits of finance) was the channelling of pension funds contributions into equity investment (Aitken, 2005; Langley, 2004). From as early as the 1940s, defined contributions retirement plans began their ascent in the US. These plans do not guarantee a predetermined level of income, and consequently they can be channelled into (riskier) investment in equity markets rather than (safer but lower yield) government bonds (Langley, 2008). Since the 1980s defined contributions plans have displaced defined benefits plans as the most popular form of retirement plan.

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[13] The 1933 Banking Act was finally repealed by President Bill Clinton in 1999 (by the Gramm-Leach-Bliley Act).

The significance of pension funds to the rise of non-bank institutional investors in the US cannot be overestimated; it is estimated that in 2005 approximately 40 percent of American common stock, or 12.9 trillion Dollars originated from pension and retirement funds (Fundamentals 2005: Mutual Funds and the US retirement Market). Similarly in 2003 institutional investors in the US accounted for approximately 75.9 per cent of the US leveraged loan market (Hickey, 2003).

In contrast, European banking remained largely universal. The full spectrum of intermediary or financial services were internalised within monolithic banks. These banks were deeply embedded in industrial structures, corporate governance, ownership and corporate finance. Critically for the specificity of European financialisation the fact that commercial and investment banking had not been systematically firewalled meant that European banks could rely on internal funds (the deposit base) for investment purposes(Forsyth and Verdier, 2003).

In turn, the continued tradition of universal banking has meant that European banks could engage in a variety of activities that US banks were unable to, such as trading on their own account and on behalf of clients. In Europe all the various functions of what were specialist agents and institutions in the United States were conducted within the banks. In continental Europe the tradition of "universal banking" originating in the $19^{th}$ continued largely unabated (episodes of crisis and nationalisation not withstanding European banks were unrestricted in conducting investment and securities businesses and consequently the European financial sectors did not experience the same 'capital vacuum' characteristic of the US (Cassis, 1992). Furthermore, even to this day most EU Member States maintain predominately state-run, pay-as-you-go schemes that essentially restrict investments to safe, low-yield domestic bond issues. This has further restricted the scope for the rise of non-bank institutional investors in Europe.

This is not to suggest that the European institutions were homogenous across the continent or that these institutions have been entirely stable over time. As noted, there is for instance, a degree of unevenness across Europe in terms of pension's provision with some states such as Ireland, the Netherlands and the UK operating deregulated pensions, while others such as Denmark have come to rely upon a more highly leveraged consumer. Similarly, mortgage-backed security markets in Europe have developed to supply a wide range of mortgage products. Further, while these institutions can be characterised as having a degree of regularity and stability they are also in flux, undergoing constant transformation. The point here is that financialisation in Europe has been built on the basis of existing and distinct institutional structures. The outcome of this process of path dependent institutional transformation is open ended rather than pre-determined and unintended consequences abound. It is to (the still unfolding) consequences of these institutional specificities for the convergence and divergence of financialisation in Europe that the analysis now turns.

## 4.3 Trajectories of European Financialisation

As noted, European banks following the introduction of the FSAP began their ascent towards reclaiming the commanding heights they had occupied in the early 19th century, attaining an unrivalled position in the asset management and capital allocation of European saving and investments. This time however the reach of the sector is far deeper penetrating ever more aspects of social life. European banks have reached beyond the industrial complexes of neighbouring societies to reach deep down into everyday life by dominating consumer credit, housing finance, and a whole range of financial services provisions. This breadth and depth of reach is indicative of a level of social control far greater than that achieved by European banks in the previous era of ascendancy, the late 19$^{th}$ and early 20$^{th}$ centuries.

In this section we focus on the primary agents driving financialisation in Europe forward, i.e. European banking institutions and trace precisely how the later are able to imbue European financialisation with their distinct interests and motivations and to what effect. What we shall see here, is that European finance has been simultaneously defined by a unique interaction between its path dependent institutional specificities and the more broad-based forces of financial innovation and change. The chapter focuses on two core aspects of the changing strategies of European banks, namely, a) internationalisation, and b) disintermediation.

### 4.3.1 Internationalisation

A distinctive and determining institutional feature of the environment in which European banks operate is the lack of a sufficient supply of assets in Europe (evidenced in the low level of household indebtedness particularly in the core Euro Area countries). This aspect, has generated perhaps the most pronounced feature of European financialisation; that is the reliance of the European banking industry on foreign assets[14]. While the globalisation of financial flows has been a notable characteristic of finance in general, nowhere has this trend been as clear as in Europe. The absence of a sufficient indigenous asset supply base has forced European banks to enter into a veritable 'chase across the globe' (Bryan, 1995). Consequently, European banks assumed the dominant position in global credit markets as the primary lenders to the developing world (see data below) as well as accumulated assets in the Anglo-Saxon world.

While many European banks had been operating branches in the most distant locations for decades already, their motivation and the scale of their activities had for a long time remained distinctively different from today. Starting at the end of the 19th century, banks from Europe and the US went abroad to support domestic industrial clients, for example, in Southern America, China, or Africa during the first wave of globalisation. Usually, however, they did not cater for local clients. With the of goods and financial markets accelerating since the 1980s, the situation has changed dramatically: granted, traditional trade finance also grew at an impressive pace, but with emerging countries rapidly gaining in importance, their markets became much more attractive and, crucially, were now open to foreigners following a process of liberalisation and privatisation. European banks have promptly seized these opportunities and invested large sums to buy into emerging markets as well as to build up capacities organically.

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[14] This relates again to the low level of middle class integration in financial markets; while corporate entities in Europe are burdened by significantly higher levels of debt than their US counterparts (which rely more on retained earnings and equity financing), European household leverage is substantially lower.

According to the Bank for International Settlements (BIS Quarterly Review, September 2008, Statistical Annex available online: http://www.bis.org/publ/qtrpdf/r_qa0809.pdf), Total cross-border bank lending has reached US$36.9 trillion in March 2008. Foreign bank loans by European banks accounted for a staggering US$25 trillion of this total, compared with only US$1.8 trillion by US banks and US$2.4 trillion by Japanese Banks. This however, is due primarily to intra-Europe lending that is considered 'foreign'.

According to the same source Bank debt to Emerging Markets accounted for 13% of total international bank debt, i.e. some US$4.7 trillion in March 2008. European banks account for three-quarters of the total $4.7 trillion in cross-border bank loans to Eastern Europe, Latin America and emerging Asia extended during the global credit boom. In absolute terms, European banks account for US$3.5 trillion of this total, compared to only US$0.5 trillion for the US and US$0.2 trillion for Japan.

Thus, European and UK banks have been extraordinarily active in lending to EM. Cross-border bank lending by European and UK banks to EM accounted for 21% and 24% of their respective GDPs, compared to 4% for the US and 5% for Japanese banks in 2008 according to the same source. Thus as a percentage of GDP, European and UK banks are about five times more exposed to emerging markets (EM) than US and Japanese banks. Austria, Switzerland, Spain and Sweden have the largest exposure to EM. By country, total loans to EM by Austrian banks amount to 85% of GDP. Switzerland ranks second on this measure, with bank lending to EM amounting to 50% of Swiss GDP. Number three is Sweden at 25%[15].

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[15] There is good cause to suspect that Greek banks' exposure to EM (especially Central & Eastern Europe) is also substantial in relation to the country's GDP, however, Greek data are not separately available from the BIS

Furthermore the same source shows that in 2008 European and UK banks have the largest exposure to Emerging Asia. In absolute terms, European and UK banks have US$827 billion and US$329 billion lent to AXJ respectively. As a percentage of GDP, these are equivalent to 5% and 12%, respectively. Take China, for example: of the total US$301 billion in foreign bank loans, European and UK banks account for US$222 billion (73% of total). Similarly, for India's US$227 billion in foreign bank loans, European and UK banks account for US$174 billion (77% of total). Thus, if Asian banks falter, the UK seems to be more vulnerable than Japan – in contrast to the Asian Financial Crisis of 1997.

The BIS report also reveals that in 2008 European and UK banks also have the largest exposure to Latin America. Contrary to presumptions, US banks do not have a large exposure to Latin America, as US banks account for only US$172 billion of US$976 billion in total bank borrowing by Latin American countries. Again, it is European banks which are at the head of this trend with Spanish and UK banks accounting for the most of the total value of Latin American exposures; the respective figures for Spain and the UK are US$316 billion, or 32% of total lending to Latin America, and US$102 billion, or 10% of total.

Finally according to the BIS report Eastern & Central Europe was the largest EM destination for G10 bank loans. Despite its relatively modest GDP, Eastern & Central European countries, together, accounted for whopping US$1.6 trillion of bank lending from G10 banks as of 2008. For comparison Asia and Latin America account for only US$1.5 trillion and US$1.0 trillion, respectively. As expected, European banks are by far the most exposed to Eastern & Central Europe. Of the US$1.6 trillion in total foreign bank borrowing by Eastern & Central European economies, European banks account for US$1.5 trillion – equivalent to 9% of European GDP. The three tiny Baltic states – Estonia, Latvia and Lithuania – have a total of US$123 billion in foreign bank loans, US$83 billion of which come mostly from Swedish banks, accounting for 18% of Sweden's GDP. Meanwhile Austrian lending to the region is staggering in particular, totalling US$297 billion, accounting for 80% of Austrian GDP even higher than Germany, Italy or France (mostly to Hungary and Ukraine).

Except in Russia, foreign-owned universal banks, using their corporate-banking arms for distribution, have mostly been quick to deploy their capital market expertise across emerging Europe. Universal banks have captured the bulk of the revenues in these markets. Local trading rooms, often with oversight from Western players, have proliferated (McKinsey, 2008). We shall revisit the role eastward financial expansion of western European banks into Central Europe, and particularly the role of Austrian financial institutions in more detail in Chapter Five.

While expansion into emerging markets draws considerable attention, investments by European banks in other developed markets must not be overlooked. This applies, in particular, to the US which is a highly attractive market for Western banks (along with some other, smaller developed markets outside the EU). In sum, many European banks – and the largest ones in particular – have thus indeed been following a “going abroad” path and have become multinational institutions. This is a significant change from only a few years ago, when most of these banks were in fact strong domestic players with rather limited foreign operations(Grahl, 2009)

Some authors identify the flow of finance outside of Europe as a sign of weakness, especially when it comes to flows of finance into the US (Cafruny and Ryner, 2007a; Konings, 2008b; Seabrooke, 2001). However, the European money flowing into the US, while of course helping to alleviate, or more accurately sustain, the twin deficits in the short term, constitutes a transfer of asset ownership to Europe over the longer term. Over time the ownership of assets are expected to generate a return. Therefore, instead of interpreting this outflow as a symptom of chronic weakness, the flow of assets abroad, a result of the institutional specificity of European finance, embodies a return of continental European states to a rentier mode of insertion in the global political economy. Further, that European financial capital, unlike oil producing countries or Asian central bankers, tends to buy strategic assets (as opposed to treasuries) implies that the outflow of European finance is a direct reflection of the growing power and influence of Europe in the world.

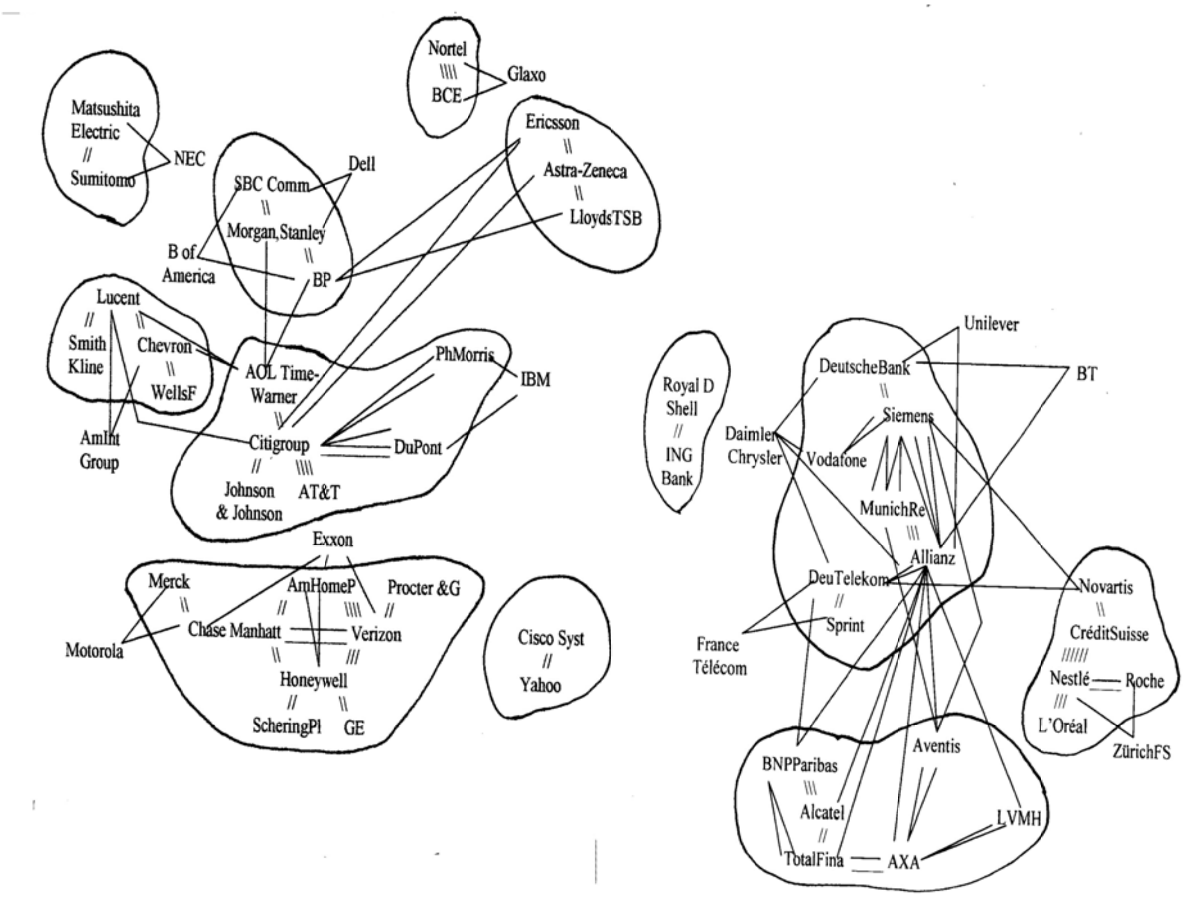
In this vein, it is revealing to explore the changing pattern of interlocking directorates between 2000 and 2005. This analysis is based on original research conducted during 2005-6 in cooperation with Professor Kees van der Pijl and funded by the British Academy (van der Pijl et al., 2010). This pattern can be viewed as a close proxy for the internationalisation of certain geographically defined fractions of capital. The resulting network has been presented so as to visualise structure in terms of the stronger and we may assume, strategically more meaningful connections. This is achieved by selecting those companies linked by two or more directors, and depicting them as clusters.

As could be expected on the basis of the foregoing discussion in the previous chapter, 2000 was a high point in European transnational strategic planning on the part of the EU corporate sector, those organised in the European Round Table (ERT) and associated banks. The 1992-2000 period was the decade in which the neoliberal turn of the EU was being effected. The horizontal diversification of EU director interlocks away from traditional reliance on the respective states at this point transpires in a visible compartmentalisation of European capital from the overall Atlantic network. In Figure 4.10, the Swiss network is connected into the French and German networks whereas in 1992 it was connected with the Atlantic network. British and Scandinavian companies are distributed over the network as a whole, underscoring notably the new bridge position of capital headquartered in the UK.

In hindsight (with the data for 2005 in hand), the 2000 network marks the half-way transition point from a US-centred transnational network to a German-centred one. The Bush Junior presidency may have been a crucial force of change here. If we retain (Palan, 2003)notion of capital as operating in a non-national, de-territorialised 'smooth' space, this space was being compartmentalised again by the US after 2000, both as a result of post-Enron regulation (the Sarbanes-Oxley legislation) and by the limits to foreign access resulting from the 'War on Terror'. By 2005 there was a drop in foreign business visits of ten percent compared to 2000, in a period of vibrant economic activity. Resistance to foreign takeovers of US assets also resulted from the response to 9/11. Such obstacles however threaten to put American capital at a disadvantage relative to its European counterparts during the period of active transnationalisation recorded in the 2000 network.

Given this picture it may not be surprising that the financial fraction within the US administration has not taken this sitting down. Hank Paulson, Treasury Secretary in the Bush administration (and former CEO of Goldman Sachs), John Thain, CEO of the New York Stock Exchange at the time (and meanwhile disgraced as head of Merrill Lynch when it had to be bailed out by Bank of America in 2008, The Independent, 24 January 2009), and others, in 2006 called for an urgent review of relevant regulation to achieve 'a "rebalancing" of the US legal and regulatory framework' (quoted by Hamish McRae in The Independent, 22 November 2006).

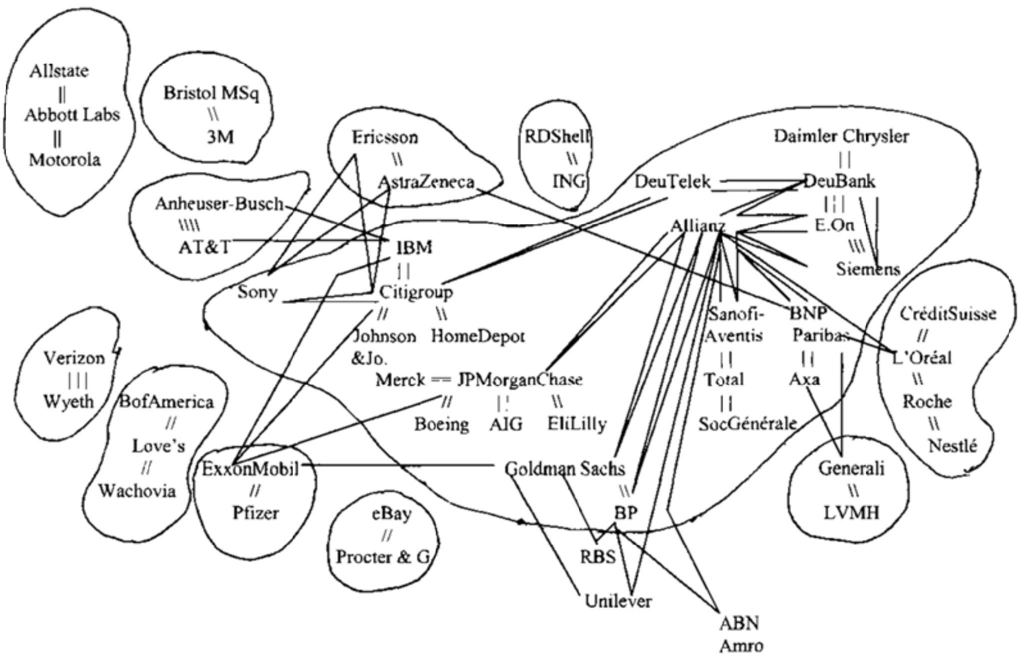
**Figure 4.10 - Clustered Joint Directorates, 150 Transnational Corporations; 2000**




Source: reproduced from (van der Pijl et al., 2010) companies by assets, Financial Times, Global 500, 4 May 2000. Clusters of corporations linked by two or more directors and corporations linked by two or more directors to clusters. Data collected by Kees v.d. Pijl with the assistance of Stijn Verbeek.

That the relative and we must assume temporary closure of the United States worked against its centrality in the international structure of interlocking directorates may be read from the 2005 network in Figure 4.11. Here German business, notably Allianz (recall that insurance groups in Europe dominate institutional money in Europe similarly to pension funds in the US) and Deutsche Telekom, have established important transatlantic connections complementing the European centrality Allianz had already obtained relative to French capital in 2000. Thus it seems that the tightening regulation in the United States in the wake of the dot com debacle had the unintended consequence of spurring the rise of Europe as a financialised rival.

**Figure 4.11 - Clustered Joint Directorates, 150 Transnational Corporations; 2005**




Source: reproduced from (van der Pijl et al., 2010) Companies by assets, Financial Times, Global 500, 11 June 2005. Clusters of corporations linked by two or more directors, and corporations linked by two or more directors to clusters. Data collected by Or Raviv

Importantly for this argument the internationalisation of European banking does not flow purely along traditional banking lines. Europe has been central to the funding of the United States' capital markets. This trend is particularly strong in relation to US securitisations. The US Federal Reserve's flow of funds data shows that foreigners hold 40% of U.S. originated securitizations. Out of a $10.8 trillion held in the shadow banking universe, about $4.3 trillion are held abroad (mostly in Europe), of which about half are held in the EMU (Harrison 2009). Therefore, European finance has not only been at the vanguard of financial globalisation along the bank lending channel, but has also been a central component in the production and reproduction of ostensibly Anglo-American financial practices.

It is to this role of European banking institutions that the analysis now turns in examining the specific admixture of bank strategies and financial innovation in the European context.

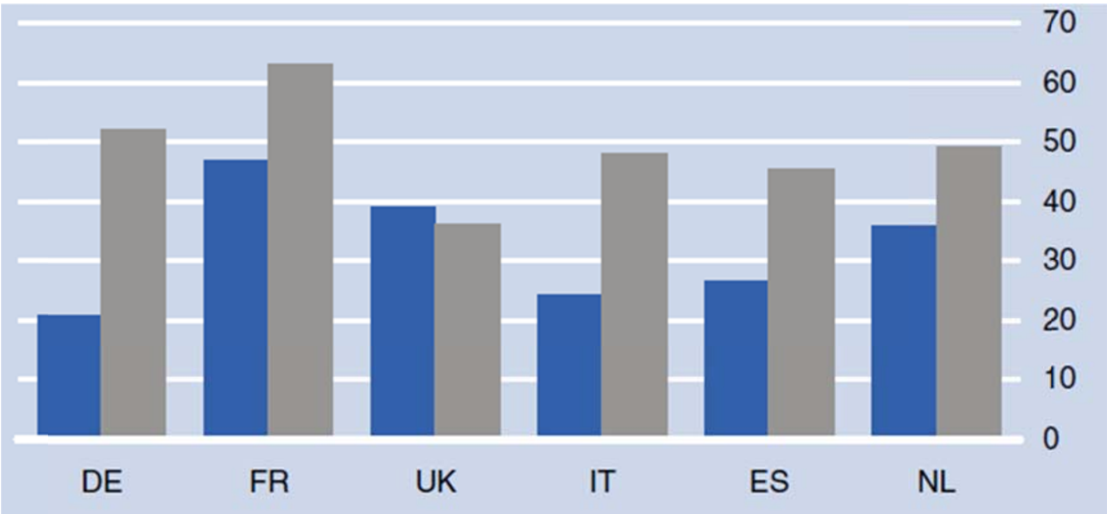
### 4.3.2 Disintermediation

No doubt, as has been previously demonstrated over the past decade financial deregulation in the EU has contributed to the gradual strengthening and growth of European equity and debt securities markets. Consequently, the recourse to capital markets proper has come to increasingly supplement traditional bank lending in continental Europe. While this recourse to market-based financing is less pronounced than the emphasis on capital markets in the United States, the gap has been shown to steadily narrow.

But it is also true that by diversifying into this area, European banking groups have been able to "internalise" the changes in their clients' saving and investment behaviour. In continental Europe, the increased recourse to equity and securities markets is therefore compatible with the preservation and expansion of the role of bank financial intermediaries. Notwithstanding increased competition from non-bank intermediaries, the importance of banks has not declined. European banks have been able to exploit their extensive retail distribution networks in order to reach investors, thus gaining dominant positions as asset managers; in many EU countries the banking sector's combined asset management goes beyond 80 per cent of total collective investment (Mörttinen et al., 2005). Thus, while the continental European finance-led growth regime shares with its Anglo-Saxon counterpart the growing importance of debt creation and financial asset price inflation based accumulation, it is distinct from it in its continual reliance on financial intermediaries for regulation and social mediation.

With the share of interest-earning assets declining on both the asset (due to securitisation) as well as the liabilities side (due to low deposit growth) and competition exerting pressure on margins, it does not come as a surprise that the relative importance of interest income in total revenues of European banks has shrunk considerably over the last decade: on the other hand, commission and fee based income as well as trading revenues rose strongly, more than compensating for the rather modest development in interest income – and driven in part exactly by a notable shift from "originate and hold" to "originate and distribute" business practices. Consequently, the share of non-interest-related revenues has soared in most EU countries, often approaching or even surpassing 50% of the revenues of respective banking industry (sees Figure 4.12 below).

**Figure 4.12 – Non-Interest Income in % of Total Bank Revenues (■1996 ■2006)**




Source: (Schildbach, 2008: 21)

EU average banks' asset growth has far outstripped the overall rates of economic growth as measured by GDP; bank assets expanded by an average of 12.2% p.a. from 1997 to 2006, compared with a rise in nominal GDP of just 4.3% p.a., thus driving up the ratio of banking assets to GDP in the EU from 240% to 333% over the same time period (Schildbach, 2008: 9).

This secular trend in European banking reflects the institutional complementarities of bank - and capital market-based financial systems and suggests that the clear distinctions, which have been traditionally drawn between these two poles may be no longer valid. Innovations in the spectrum of products available to banks in managing their balance sheets and a shift to a portfolio wide approach to risk management has ensured that even the most ‘plain vanilla’ lending relationship is embedded in complex webs of asset and liability management techniques, largely executed on capital markets proper or in unregulated parallel spaces. Put simply, the term “complementary ” describes the tendency in recent years of capital market activities and traditional on-balance sheet banking to become ever more interlinked or even intermingled – often not substituting, but complementing each other (Konings, 2008a; Seabrooke, 2001).

However, complementarities do not only point to ever stronger linkages between on-balance-sheet banking and capital markets, but also the tendency of borrowers as well as investors to increasingly access capital markets directly without relying on conventional banking services. In the process of “disintermediation”, the activities of banks – the traditional “intermediaries” – thus shift more and more from borrowing and lending towards providing advice, supplying market liquidity, underwriting and other fee-yielding services related to capital markets(Erturk and Solari, 2007).

Accompanying this shift to a more market based model, a broad variety of product innovations have enabled banks to increasingly switch to a new model of “originate and distribute” that has been deemed to be of benefit to banks and customers alike. The most recent of these innovations is the credit derivatives market. Credit derivatives are a form of derivative contract, which references the probability that a borrower (the credit, the referenced entity, or the ‘underlying’) will not be able to meet payment obligations. In the contract one party sells protection on the underlying credit, promising to make a payment to the buyer on realisation of a credit event (the debtor does not pay). In return the protection buyer pays a periodic fee to the seller over the life of the contract (Wigan, 2009).

Through this technique what were idiosyncratic exposures to borrowers are rendered tradable, and in consequence credit relationships have been commoditised. Banks can use credit derivatives to rearticulate their relations to borrowers. In the simplest of terms, banks are able to lend money, or originate credit, then sell on their exposure to that borrower by buying protection against their default. Notably, the borrower or the bank's client will not necessarily be aware that the lender sold on their credit risk so client relationships are in theory left unscathed(Bryan and Rafferty, 2006a, c; Wigan, 2010).

A closely related technique is that of securitisation. In a traditional securitisation the issuing institution assembles a package of credit exposures (bonds, loans, receivables) and sells them on. This combination can be structured in complex ways to produce new payment profiles and exposure hierarchies. In large part, it is this capacity that led to the promulgation of broad array of exotic structured products with little understood embedded 'payment waterfalls', correlations and counterparty exposures. These product features rested at the heart of the failure of market participants, regulators and policy makers alike to apprehend the immanence of the current crisis (Wigan, 2009).

Between 2003 and 2008 the securitisation and credit derivatives market became tightly bound by processes of cross-fertilisation between asset backed securities, such as the now infamous Mortgage Backed Securities (MBS), and credit derivatives. For instance, credit derivatives could be written to reflect the performance of a pool of bonds, these could be amalgamated in a synthetic CDO, grouped in tranches with varying exposures, then merged with a separate MBS to form a hybrid structured finance instrument (Wigan, 2010).

The repackaging of ordinary loans and receivables into tradable securities can be applied to virtually any debt, be it mortgages, consumer and credit card loans or auto credit and corporate debt (which leads to a veritable 'alphabet soup' of acronyms such as ABS, RMBS, CDO, CLO, hybrids et al. that have recently gained a certain notoriety). In addition, the securities can be sliced into different tranches of risk, with different probabilities of default, to meet the specific preferences of individual investors. Securitisation therefore allows both banks to enhance their credit risk management – and generate revenues from the process as such – and investors to invest in fixed income products that are much more tailored to complement their portfolios efficiently than traditional corporate or government bonds(Bryan and Rafferty, 2006b; Wigan, 2010).[16]

Crucial here is that credit risk transfer (CRT) instruments such as credit default swaps (CDSs) offer banks the opportunity to actively manage their credit risk instead of letting it evolve passively. In principle, the protection buyer – the lender – enters into a CDS agreement with the protection seller – the insurer – to pay a regular fee in exchange for the guarantee to be repaid the insured amount of credit in case the borrower defaults. From a micro perspective, hedging the credit risk thus frees up the regulatory capital of banks previously required to back risky assets and makes granting new loans possible. The promise on a systemic level is that by making these assets universally tradable risks previously held statically in the banking system could be managed dynamically through a much broader universe of agents.

Through CRT for instance, selling protection, or 'insuring', bonds and bond-like securities, AIG Financial, an arm of the giant US insurer, was able to turn itself into a virtual investment bank, taking on and managing exposures previously held exclusively in the banking system. In theory and on the basis of the principle of diversification this arrangement would ensure that risks were more dispersed, held by those most willing and able to manage them, and therefore systematically optimised. It is on the basis of this discredited faith in the powers of diversification, modern finance theory, and financial innovation that the regulation of European banking proceeded (Krugman, 2009).

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[16] Crucially however, banks do not eliminate risk completely, but rather replace the counterparty risk of their client with that of the protection seller (which should presumably, be considerably lower).

The Basel capital adequacy rules, which were implemented in the EU with the Capital Requirements Directive (CRD), serve as the centrepiece of prudential regulation of the banking sector. Initially proposed in 1988 (BCBS 1988), the rules were substantially amended in 2004 (BCBS 2004), and generalised the use of credit ratings for risk weightings in the external ratings-based approach, and the use of internal models for more advanced financial institutions. Basel sets a minimum capital requirement of 8% for the banking book, but the differentiation of risk weightings prevented supervisors from noticing the growing degree of leverage in the financial system. For example, the Belgian bank Dexia, an early casualty of the crisis, had a Basel tier 1 ratio of 11.4% in June 2008, but a core capital ratio of only 1.6%![17] (Evans-Pritchard, 2008)

However, what is significant here is that by moving to capital adequacy regulation calculated on the basis of a bank's exposure as the sum of risk management practices, the CRD effectively promoted aggressive expansion of leverage. Banks could originate more and more credit on the basis that the regulatory capital charge would not rise so long as the exposures could be either hedged out through derivatives or removed from the balance sheet altogether through securitisations(Wigan, 2009). As further exploration of the case of AIG affirms the impact of this evolution in regulation and bank practices.

The links forged by innovation across global financial markets have been exposed by the recent implosion of AIG Financial. What is critical is that the driver of these links has been regulatory arbitrage (NakedCapitalism, 2008a). AIG latest annual report reveals that it had sold protection on a value of US$ 300bn to European banks(Seeking Alpha, 2008b). AIG itself has been quite candid about the purpose of these contracts, they were written '…. for the purpose of providing them with regulatory capital relief rather than risk mitigation in exchange for a minimum guaranteed fee' (Henry et al., 2008).

[17] In the context of the current crisis and the asset price bubble addressed below, a key weakness in the risk-weighted system of the Basel framework is the strong bias towards real estate. Capital charges for mortgage lending stand at half that applied to commercial loans, and can go to 35% for residential mortgages.

AIG thus helped to organise regulatory arbitrage on a gigantic scale. According to Daniel Gros, Director of the Centre for European Policy Studies, Brussels*, '…A formal default of AIG would have had a devastating impact on banks in Europe…'(Gros and Micossi, 2008)*. This explains why AIG's problems had sent shock waves through the share prices of European banks. In rescuing AIG the US state in the guise of the Treasury has effectively saved, *inter alia*, the European banking system (Jones, 2008b).

Thus, banks on both sides of the Atlantic are increasingly reliant on the business of turning mortgages and other kinds of debt into complex bond-like products to generate a significant share of their profits. Banks globally saw revenues of almost $30bn from asset-backed securities business in 2006, which analysts in JPMorgan estimated is as big as the revenues generated by equity derivatives or cash equities trading. In Europe, Deutsche Bank and Credit Suisse, two of the largest in the field, rely on ABS activity for about 10 per cent of group pre-tax profit(Schildbach, 2008). Issuance volumes in these markets has grown more than six-fold from about $500bn in 2000 to more than $3,000bn in 2007, about 77 per cent of which was from the US. US banks earned revenues of about $19.9bn from this business while their European peers gained about $7.5bn. Four of the top 10 institutions saw revenues of more than $1bn from their ABS businesses. Deutsche Bank is the clear leader, generating more than $2bn and earning pre-tax profits from that of more than $1bn, which is almost 11 per cent of group profits (Schildbach, 2008). The second biggest player in Europe is Royal Bank of Scotland, with ABS revenues of $1.7bn and made more than 4 per cent of group profits from the business (FT, 3 June 2007).

But not only Europe's big banks engage in securitisation and other off balance sheet activities – even the small publicly owned and 'financially laggard' German banks were in on the party. The failure and rescue of IKB after it was exposed to risky credit instruments highlights how German banking changes have led to some institutions taking on more risks and reveals just how vulnerable they are. The country's three-pillar system of private, public and co-operative banks is Europe's most fragmented lenders' market (Tett et al., 2007). In broad terms, the public sector Sparkassen, or savings banks, and Landesbanks, regional state-owned lenders, dominate the retail market while the large private banks, including Deutsche Bank, Commerzbank and Dresdner Bank, rule the investment banking arena. Everyone competes to lend money to corporates.

The public and private banks have stepped up competition on each other's turf, resulting in lower profit margins. Faced with reduced profits at home, Landesbanks such as WestLB greatly increased their presence in the capital markets from the 1990s. WestLB established in-house private equity and proprietary trading businesses and tried to compete with the likes of JPMorgan and Deutsche Bank in the bond market (FT, 12 August 2007). IKB took a different route to the capital markets. In the late 1990s, the bank, which is private and listed but controlled by KfW, the state-owned bank, started securitising the thousands of loans it had to German Mittelstand companies, seemingly increasing efficiency at the bank. As a serial issuer of structured fixed income instruments, IKB built up an in-house expertise in these markets. The bank decided to further exploit its new-found knowledge in 2002, when it set up Rhineland Funding, an investment vehicle designed to buy asset-backed structured finance products such as collateralised debt obligations (CDO). Rhineland had expanded rapidly and had almost €20bn ($27.3bn, £13.5bn) worth of outstanding commercial paper in the markets in July 2007.

Rhineland was not on IKB's balance sheet, but managed by the bank's investment experts and supported by nearly €15bn in credit lines from IKB and other banks. It would borrow short-term capital in the commercial paper market and invest in assets with longer maturities. However, as the crisis erupted commercial paper investors, those supplying the cheap short term funding, withdrew their funding from Rhineland amidst concerns about the fund's exposure to US subprime mortgages. Other banks cut their lines to IKB, given its huge exposure to the fund. The subsequent rescue operation included KfW taking over the €8.1bn credit line and pledging to cover up to €1bn in losses. KfW also organised a €3.5bn banking pool with the public and private banking associations.

It was the bail-out, not the failure that made IKB stand out from other casualties of the crisis. Fragmentation in the German market means the banks are too small and not profitable enough to weather these problems. IKB, for example, has €52bn of assets and a market cap of just €1.3bn – making it a comparative minnow (FT, 12 August 2007).

## Conclusion

To this point this thesis has addressed transformations in global finance from both macro and micro perspectives. The theoretical chapter argued for the purchase of the concept of a finance led growth regime in the analysis of the neoliberal project in general, and in Europe in particular. The study of the phenomenon of contemporary finance was posited to potentially illuminate broad changes in the social constitution of an, 'optimally calibrated economy'. Crucially, the notion of financialisation captures well the penetration of finance not just into broad macro-economic patterns or patterns of accumulation, but also at the level of the everyday. This penetration through a complex process of institutional transformation was argued to belie any interpretation of finance in the wake of the Bretton Woods system as disembedded, a flywheel on top of the world economy.

Elaborating upon the historical specificities of the current political project of a Europe designed to compete in the new century the analysis further conceptualised this project in terms of the role of the contender state. In this context the European project to actively promote financial integration was understood to incorporate not just an expanded geographical unity, but also, and critically, a wholesale restructuring of the very constitution of European finance, and thus a specifically European financialisation.

This chapter has in turn examined the outcome of this politically instigated, top down programme for Europe, again from a micro and a macro perspective. Emphasis has been placed on the institutional specificities of the European tradition and experience, while firmly placing these in a trans-Atlantic constellation and a phenomenon, which is both global and necessarily diverse. Europe following its own trajectory and on the back of distinct institutional features emerged as the financialised contender, and especially as a credit powerhouse for the developing world. It is clear that the European experience has been marked by both successful interventions in a global financial market place, as was the case with the evolution of interlocking directorates, or less successfully as was the case with IKB. Institutional complementarity was thus shown to be in no way automatic, and the outcome of developmental trajectories in European finance in no way determined exogenously.

That European banks have been emboldened by their policy elites to pursue ever more risk seems to have left the European system in a curious bind. On one hand Europe has on many gauges regained a position of ascendancy last seen at the beginning of the last century, while on the other hand Europe was vulnerable to the onset of the systemic crisis and it now in a precarious position as the crisis continues to develop, evolve and unfold.

One notable feature of the European experience has been the purposeful, political and seemingly, at least in quantitative terms, successful effort to globalise Europe's financial agenda and reach. Nowhere has this strategy been more pronounced than in central Europe where states, locked into an exogenously defined trajectory by the accession process and the recipients of the largest credit flows from Europe, have becomes heavily enmeshed in what has been shown to be a distinctively European process of financialisation. It is to this that we now turn as the next chapter examines the experience of European finance to its east, and reflects upon the institutional trajectory it reveals both for European finance and the countries who now are the chief object of an on-going 'chase across the globe' (Bryan 1995).

# 5. Central Europe in the EU embrace

## Introduction

Over the past decade, the financial sectors of Central Europe have been fully integrated into the Western European structures of financial accumulation. Here, the neoliberal principals of economic management, first introduced by the International Monetary Fund (IMF) in the early 1990s, were subsequently 'locked in' by the process of EU accession. Consequently, foreign financial direct investment resulted in a dramatic overhaul of ownership structures in local financial systems. In 1994, in the wake of the early transition crises, an overwhelming majority of financial intermediaries in the formerly communist countries were still publicly owned. In contrast, at the eve of EU accession in 2004, a mere decade later, private foreign ownership already accounted for well over three quarters of financial intermediaries' assets in the region (and has continued to rise since). These figures are especially striking when compared with just under a quarter of foreign owned banking assets across the EU25 and 15.5 percent in the Euro area (ECB, 2005:11).

Foreign (predominately Western European) financial institutions have subsequently acted as primary conduits, channelling growing volumes of financial inflows into the region, and fuelling a rapid growth in liquidity and credit. Since 2003, as recovery in the global economy from the dot com bubble got underway, credit to GDP has expanded annually at double digit rates in all the Central European New Member States, exceeding an average annual growth rate of 30% for the region as a whole (Backé, 2006; Boissay, 2005; Enoch, 2007). While similar trends of increasing foreign ownership, followed by episodes of rapid credit expansion, are evident in emerging markets across the globe, (for example in pre-crisis Asia) such a drastic shift is unprecedented, both in scope and speed.

Indeed throughout the 1990s, the liberal norm of unfettered capital mobility attained near universal applicability. Amongst the developed nations, capital mobility was codified and institutionalized in the charters of organizations such as the Organisation for Economic Cooperation and Development (OECD) as 'one of the defining—the constituting, the proper—practices of a developed country', the EU was in no small part responsible for this (Abdelal, 2006:15). Throughout the developing world too, capital account liberalisation was similarly prescribed (and legitimated) on the basis of identical arguments, irrespective of national economic differences. Easier access to global financial markets would lead to a more efficient allocation of capital at a reduced cost, and to improved investment opportunities for businesses and households alike, resulting in growth in output and employment. Access to foreign finance would further enhance the depth and liquidity of national financial systems, thus, reducing systemic risk and promoting financial stability.[18]

This (foreign) investment-led growth strategy was, and still is, continuously backed up by a steady flow of studies, reports and recommendations, emanating from the various international financial institutions as well as academia, lending credence to these theses and depicting foreign investment as a panacea to the problems of the developing world. Examples for the dominancy of this perspective abound, particularly within the pages of business and economics journals, as well as in the official publications of institutions such as the World Bank, the European Bank for Reconstruction and Development (EBRD) and the United Nations Conference on Trade and Development (UNCTAD) (cf. BIS, 2004; Claessens, 2001; Focarelli, 2000; Levine, 1996; Levine, 1999 amongst many others)).

[18] Neoclassical economics, whether relying on endogenous or exogenous growth models, suggests that foreign investment and (closely correlated) technological innovation will combine to generate a 'virtuous' growth cycle. Arguably, even if this were the case, given the importance of financial systems for the process of capital accumulation, economic growth, and social cohesion, the level of foreign ownership should raise concern about the transfer of regulatory power and economic discipline into foreign and private hands.

Conversely, this chapter shifts the focus away from the developmental needs of the Central European host economies (the 'pull factors'), in favour of addressing the market pressures and structural contradictions facing credit institutions operating in the already financialised economies of Western Europe (the 'push factors') as discussed in the previous chapter. Arguably, the actual motivations and strategies of Western European credit institutions in their Eastward expansion were never geared towards addressing the developmental needs of host Central European economies. Rather, they were aimed at redressing, and geographically diffusing, the structural contradictions they faced in the already financialised economies of Western Europe.

The empirical evidence introduced in this chapter demonstrates that indeed so far the financial integration of Central Europe failed to generate the promised optimisation of investment, promote efficient economic management and enhance welfare levels, let alone reduce macroeconomic risks in the region. On the contrary, foreign financiers emerged as a powerful rentier class in Central Europe, able to extract rent incomes far in excess of their profits in the west. The concentration of disciplinary power in the hands of foreign financiers further contributed to a reorientation of state policy, corporate strategy and households' practices, in line with the imperatives of financially based accumulation strategies, resulting in a transfer of property rights to foreign investors and increased indebtedness and risk to host societies, both of which have been proven ultimately unsustainable by the collapse of credit levels and destabilizing currency crises which ensued since the current global credit crisis erupted.

The rest of this chapter is organised as follows. The following section focuses on the key political drivers, processes and institutional features of the makeover of economic institutions and policies in Central Europe along neoliberal (finance-led) lines, framing it in the context of EU accession. Section two adopts a long historical perspective to account for the primacy of particular financial agents in Central Europe (namely, Austrian universal banks). Section three explores the strategies deployed by Western credit institutions in their Eastward expansion and highlights the socioeconomic effects of the integration of Central Europe into the Western European financialised structures of accumulation. Section four concludes.

## 5.1 The Politics of Eastward Financial Expansion

Contrary to the popular yet simplistic notions underlying classical and (Hayekian) neoclassical economics, markets, financial or otherwise, do not 'spontaneously' materialize in the space vacated by the state. Rather, the construction of markets as social institutions requires a significant amount of political commitment and action. In his seminal book *The Great Transformation,* Polanyi observed that in Great Britain, the bedrock of modern capitalism *'The road to the free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism'* (1944:140). Altvater similarly warns that *'... the notion that the market mechanisms themselves initiate the necessary transformation to another model of regulation could turn out to be - in both the West and the East - a frustrating and dangerous illusion'* (1993:53).

The significance of the state was especially pertinent in the case of reforming the post-communist Central European financial systems. At the end of World War II, the Central European economies were integrated into the Soviet command structures. Like all other private enterprises, banks and other financial institutions were nationalized. Financial intermediation (the gathering of savings and consequent reallocation for the purpose of investment) in centrally planned economies was conducted by states at the national level, and by the Soviet Union at the bloc level. Under such conditions of financial repression, capital markets (in the Western sense) did not hitherto exist. To be clear, state-owned banks existed and collected savings, however these funds were then allocated on a political basis with little or no regard to economic performance. Thus in centrally planned economies banks fulfilled an accounting function for the actions of government rather than provided intermediary services in a liberal market environment.

Thus, far from a simple abrogation of state responsibility and intervention, establishing privately owned financial systems in Central Europe required a process of genuine institution building. Moreover, the restructuring of Central Europe's political and economic structures did not take place in a vacuum or on a *tabula rasa,* but in a society entwined with pre-existing social ties, with institutions that either survived from state socialism or were built upon their ruins, and with attitudes, understandings, and behavioural patterns strongly shaped by the previous system (Pavelink, 2003).

Thus the subsequent ‘financial socialisation’ of post-socialist societies, (i.e. reconstituting post communist subjectivities in line with the exigencies of global finance), entailed nothing short of a comprehensive exercise in social engineering, coordinated by intensive and continuous state intervention. Thus, the financialisation of Central Europe should be viewed firstly as an inherently political project.

As suggested in chapter two, whereas accounts of financialisation in Anglo-America tend to suffer from a ‘domestic bias’, the opposite is true outside the Anglo-Saxon heartland, where financialisation is often cast as an almost entirely exogenous process, thrust upon powerless societies by nameless and faceless market forces against the backdrop of the global hegemony of Anglo-Saxon neoliberalism. It is certainly the case that the ideological and institutional vacuum left in the wake of the de-legitimization of actually existing socialism provided fertile grounds for intervention by a host of Western public and private agents alike (De Boer-Ashworth, 2000).[19] However, it is also important to note that the political movement away from communism and towards rejoining the Liberal, Western political and economic order enjoyed extensive support amongst the intellectual elites and broader civil society constituents within these newly independent political systems. This was as much an outcome of the rejection of the communist ideology and its class discourse as it was a product of the global hegemony of neoliberal ideology (Eyal, 1998; Konrad, 1979).

Activists against communism in Central Europe (many of whom were now part of the governing structure) were attracted to the ideal of 'civil equality' and the attack on particularist privilege. The political movements in this region, therefore, tended to be pro-democracy rather than pro-capitalist. The confusion between values of liberal-democracy and the methods of capitalism would eventually result in considerable disappointment with the transition. Central European policy-makers who basically attempted to design a political system based upon Western ideals of human emancipation, were jaundiced with the reality of the economic experience in the form of capitalism (Wood, 1997).

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[19] In the aftermath of the collapse of the Soviet bloc the former communist states were plunged into a crisis, which, in terms of economic output, rivalled the great depression of the 1930s (cf. Milanovic 1998). In the early years of transition, the IMF wielded considerable influence in the region through its principles of conditionality, although a range of other institutions and organisations, as well as swarms of foreign advisers, also played a distinguished role (notable examples include Harvard Professor of Economics, Jeffery Sachs, a formal adviser to the government of Poland and financial mogul George Soros, adviser to the government of Hungary).

It could be argued that the confusion detailed by Wood's article, is not the result of pure accident. Those who support market capitalism often use the language of the Enlightenment to justify the spread and effects of market capitalism. And the principles of the Enlightenment *are* appealing. Undoubtedly, it was the appealing prospect of acceding into the EU, formally endorsed in the European Council's Copenhagen Summit in 1993, which served to entrench the political commitment to the neoliberal reform agenda even as the short-term costs of transition began to materialise in the form of rising unemployment and deteriorating state and enterprise social provisioning.

Central European countries expected to be shielded from the worst effects of global neoliberalism through the process of EU accession. What they received however was in some ways even more significant; EU accession provided them with a concrete and robust template for institutional reform which they desperately needed. Jean-Paul Fitoussi suggests that after the collapse of the East, the Western solution was that they should adopt the West's system. However, in Fitoussi's words, *'all we had as the dominant representation of our system was its theoretical descriptive categories'* (Fitoussi, 1997). In practice, none of the Western economies had become totally capitalist, in the sense of a completely unfettered free-market. This being the case it becomes difficult to talk about 'capitalism' as a concept because it is impossible to extricate exactly what it means within any society.

In turn EU membership itself was offered on the non-negotiable condition of adopting the entire existing catalogue of EU legislation (the acquis communautaire). Unlike existing EU members, new member states cannot opt out of Euro Area membership either.[20] Thus, acceding into the EU implied submitting to a rapid and comprehensive regulatory reform with the explicit aim of bringing about regulatory convergence with the EU. Consequently the process of EU accession has constituted the primary political process underwriting the political, economic and social restructuring of the Central European post-communist states. Their recent 'formal' accession in May 2004 has effectively sealed off any retreat.

20 They are also required to adopt the ERM II. The ERM II is in effect an interim mechanism, a 'waiting room' for countries aspiring to join the Euro Area; prior to acceding to the Euro Area countries are required to maintain a plus/minus 15 percent currency exchange rate bandwidth around the Euro for a minimum duration of two years. This has left them with all the problems of controlling their currency exchange rate in an environment of unregulated capital flows, whilst enjoying none of the benefits of cancelling currency exchange risks by being in the actual Euro Area

Protection from neoliberalism however, was not part of package. The strategic reorientation of the Western European economy, itself premised around the neoliberal, finance-led principals of economic governance (and particularly the re-emergence of unfettered capital mobility) commenced parallel to the dissolution of the Soviet bloc (Moravcsik, 1998a). The 1992 Treaty of Maastricht paved the way towards European Monetary Union (EMU) and formally recognized neoliberal convergence as the basis for further integration. The 1996 Stability and Growth Pact (SGP) further entrenched these goals and also consolidated the role of European institutions in monitoring and enforcing national monetary and fiscal compliance with the targets set forth in Maastricht.

This demonstrates how the neoliberal agenda has become inscribed in the thinking and practice of European institutions, prompting critics of the EU neoliberal agenda to conclude that *"the leading political and economic forces in Europe present neoliberalism as a taboo that cannot be violated"*.(Milios, 2005:209). By equating neoliberal convergence with the goal of enhancing the economic, monetary and political unity among EU member states the neoliberal strategy is effectively exempted from criticism and placed out of reach for 'any substantial revision or change' (Ibid). Thus, the process of Eastward Enlargement itself becomes a mechanism of imposing and observing neoliberal discipline; the deepening and broadening of integration a vehicle of conversion to neoliberalism.

It was these disciplinary aspects that all aspiring new member states were directly confronted with; acceding into the EU implied a comprehensive restructuring of social and economic governance. Accepting the EU option meant submitting to comprehensive neoliberal restructuring; committing to reducing barriers in the internal market and to the convergence of monetary and fiscal policies towards maintaining price stability through direct inflation targeting (Topowrski, 2005:215-222). This restructuring process was of course a necessary precondition for the expansion of Western finance which can only operate within the context of a Western based normative and regulative framework.

## 5.2 Banking in the Austro-Hungarian Empire

Before addressing the current expansion of Western financial capital into Central Europe it is important to note that the societies of Central Europe have in fact, already constituted a part of the Western European political and economic order once before. In November 1995, at the eve of launching the accession negotiations, The Economist published a survey of Central European countries titled '**The return of the Habsburgs**'. The Economist expressed enthusiastic support for the speedy integration of the five (the 'Visegrad four' and Slovenia) Central European countries on the basis of common heritage ('pedigree'). The countries of Central Europe can

trace their western roots 1,000 years back-to a time when medieval German kings launched the Holy Roman Empire (headed, in due course, by the Habsburgs) and set about Christianising nearby Slavs by the sword … …They are the Hungarians, the Czechs, the Slovaks, the Slovenes and, particularly, the Poles, … …the Central European nations hold common credentials for entering the EU: they will be not so much joining Western Europe as coming home to it. (The Economist, November, 18th 1995).

Indeed, Central European societies formed a part of the Austro-Hungarian Dual Monarchy, and thus, partook in the Western European political and economic order during the 19th and early 20th centuries. However, having established these so called credentials, the Economist displayed remarkably little interest in the nature of that previous integration, or in its effects on CE societies.

In fact, integration under the Austro-Hungarian Dual Monarchy took the form of military, political, economic and religious domination and subjection. Central Europe's previous 'western experience' was a brutish imperialistic tale of exploitation and expropriation. In this section I examine the role played by Western financial capital in this previous episode of integration; to be clear I'm not suggesting that the EU as our present-day equivalent to Austro-Hungarian empire, however, arguably, this longer historical perspective will prove instrumental in promoting a more nuanced understanding of the dynamics, institutional features, and agents involved also in contemporary financial relations between Western and Central Europe.

From the mid 19th century, the Austro-Hungarian Empire, much like the rest of continental Europe, entered a phase of rapid industrialization and economic development. This expansion led to a growing demand for credit. At the time, several private banks were already operating in the Austro-Hungarian Empire; however these were unable to satisfy the growing demand for credit.[21] Capital markets on the continent were similarly underdeveloped, mostly as a result of restrictive financial regulation, particularly, company and tax law which restricted the establishment of joint stock enterprises.[22] The ensuing credit crunch prompted the rise of a new form of financial institution in Europe; the universal bank[23].

Universal banks are those institutions that combined the short-term business of deposit banking with the long-term activity of investment banking, and, in addition, performed stock-broking functions, managed clients' portfolios, acquired shares and voting rights in joint-stock companies on their own and their clients' account. With the exception of the United Kingdom, and, possibly, also France, universal banks spread throughout Europe during the phase of buoyant expansion in capitalism from the 1880s to 1914. Close relationships between industrial companies and banks developed everywhere, although the pace at which this happened differed somewhat from country to country. Germany is often seen as a 'model' of this trend, however, the union of banking and industry was also especially marked in the Austro-Hungarian Empire (Teichova, 1997:215).

21 the Osterreichische Nationalbank was founded in 1816 followed by the Niederosterreichische Escomptegesellschaft which was granted imperial charter to provide services to trade and industry in Lower Austria in 1853; Wurm, 2006).

22 The regulatory environment changed in 1899 with the repeal of restrictions on joint stock limited liability companies, paving the way for the conversion of bank credit into equity positions.

23 For a detailed account of the rise of Universal Bankning in the Austro-Hungarian Empire see for example Teichova, 1997; 2005; Rathkolb et al. 2005; Wurm, 2006).

In 1855, the first Austrian Universal Bank, K. k. privilegierte Osterreichische Credit-Anstalt (hereafter Credit-Anstalt), was founded. The main subscriber to the Credit-Anstalt's equity was the Viennese House of S. M. von Rothschild. Credit-Anstalt remained the only universal bank in operation in the Habsburg Empire until the establishment of Allgemeine osterreichische Boden-Credit-Anstalt in 1863. In 1864 the Anglo-Osterreichische Bank was founded and in 1869, the Wiener Bank-Verein, an associate of the Boden-Credit-Anstalt commenced activities (Teichova, 1997:216). These universal banks represented the primary (almost exclusive) source of credit in the Austro-Hungarian Empire. Indeed, during the period 1880-1913 bank credit to industrial enterprises quadrupled (Teichova, 1997:219). The bulk of this growth was in short-term credit which was later to be converted into shares.

The Austrian banks fulfilled the usual functions of financial intermediation as in other capitalist economies  and offered a variety of services for business and private individuals such as deposit and investment banking, stock-broking, portfolio management, and acquisition of shares in joint-stock companies (on their own and on their clients' behalf). As in other countries close ties between banks and industrial enterprises developed. However, in the absence of alternative sources of credit, and of legal constraints to bank ownership of industrial enterprise shares, the big commercial banks of Vienna secured a more prominent control over the allocation of capital than their counterparts elsewhere in the continent. Bank ownership of shares entitled them to voting rights in joint stock companies and their supervision was further tightened through interlocking directorships and serving on the board of their client companies.[24]

[24] Hilferding (1910) was amongst the first to regard the relationship between industrial and banking capital as a power relationship.  Through observing the development in Austria and Germany he concluded that banks directly and deliberately promoted further concentration through mergers and cartelization.  Gerschenkron (1965) similarly recognized the growing power of banking capital particularly in 'latecomer' economies where capital is initially scarce.

The Viennese banks also played a dominant role in the penetration of Central Europe. In 1918 the ten biggest Viennese banks operated some 143 branches outside of Austria. Ranki (cited in Teichova, 1997:219) has estimated that in 1913 only one Hungarian bank was of the same magnitude as the leading Viennese institutions - the Hungarian General Credit Bank – which itself was linked to the Austrian Credit-Anstalt. In Bohemia only one bank maintained significant capital resources, the Zivnostenska banka of Prague. Teichova (1997:219) writes:

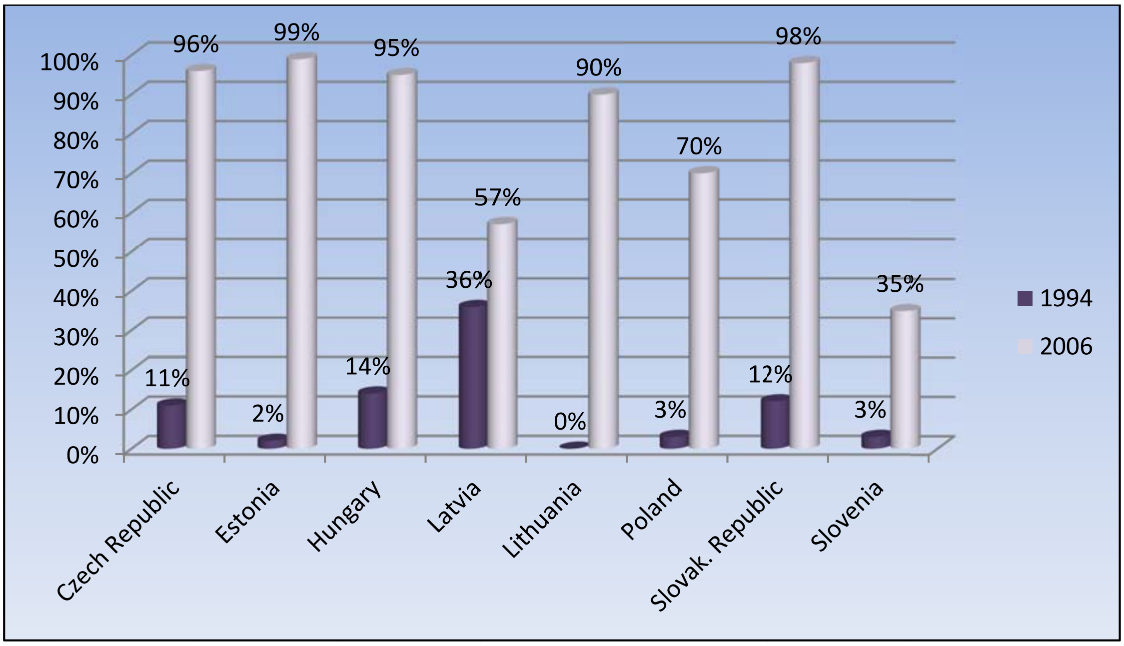
By 1914 the eight great Viennese banks accounted for about two thirds of the total capital of all the financial institutions of the Empire. These institutions had secured strategic positions in almost all branches of industry and their influence radiated out from Vienna to encompass all the territories of the Dual Monarchy.

Thus, by the early 20th century, the imperially chartered, universal banks of Vienna had seized control over significant shares of the corporate sectors of the newly industrializing economies of Central Europe. This strategic position enabled them to also capture or expropriate a growing share of productivity growth in the region in the form of rentier incomes. This dominance of the Austrian banks continued unbroken right up until the dissolution of the Austro-Hungarian Empire at the end of World War One, as one by one the nations of Central Europe declared independence. This left the Viennese banks in a precarious position, as they lost almost all of their braches outside Austria and consequently, their control over their most profitable clients which were now on the other side of the Czechoslovakian and Hungarian sovereign borders. It is a testament to the profitability and income that Viennese banks were able to extract through their domination of industry in Central Europe that the loss of this business resulted in further concentration in the Austrian financial sector as banks merged or went under, and in ever increasing penetration of the by now much weakened Austrian market itself by foreign interests, mostly British and French.

## 5.3 Financial Strategies in Central Europe

If one judges the success of Central European governments in reforming their weak and distressed financial systems by their ability to attract strategic foreign investors, than the reform must be considered nothing short of a staggering success. The three largest financial sectors in the region, Poland, Hungary and the Czech Republic adequately represent the broader transformation in ownership structures that took place in the region over the past decade. In 1994, in the wake of the early transition crises, an overwhelming majority of financial intermediaries in the formerly communist countries were still publicly owned. In contrast, by 2006, foreign ownership accounted for 96 percent of banking assets in the Czech Republic; 95 percent in Hungary; and 70 percent in Poland (see Figure 5.1 below). In Poland, PKO, the last major state-owned bank (51.57 percent owned by the State Treasury, the rest floated on the Warsaw Stock Exchange) represents nearly the entirety of the remaining domestic owned banking assets. In Hungary, OTP Bank, considered domestically owned, accounts for most of the remaining banking assets, however, almost 80 percent of its shares, which have been floated on the Hungarian stock exchange, are reported to be foreign owned (The Banker, 03 October, 2005). In the Czech Republic domestic banks are insignificant in terms of share of asset ownership.

**Figure 5.1 - Market share of foreign-owned banks in total banking assets 2006 (%)**




Source: Local Central Banks, EBRD Transition Report 2006 'Finance in Transition'.

The current financial expansion into Central Europe was similarly channelled through financial intermediaries rather than equity markets. Market capitalisation and liquidity on the stock exchanges in Warsaw and Budapest have indeed deepened significantly in recent years, buoyed by a variety of government legislation aimed explicitly at propping-up these nascent capital markets. For example a recent reform to pension regulation in Poland requires pension funds to invest a minimum of 40 percent of their portfolios in the local stock market – 95 percent of which must be invested in local firms. However, these recent developments notwithstanding, financial intermediaries still account for approximately 85 percent of financial sector assets in Central Europe (Backé, 2005). This is to be expected given the prominence of Western Europe in the region, both politically and financially. It is for this reason that the following analysis will focus exclusively on the strategies and developments within the banking sectors of CE

However, much to the surprise of some financial experts, the initial eastward drive was not led by German credit institutions despite the vibrancy of Germany's financial sector and its position as the region's biggest trading partner, but rather by its much smaller Austrian neighbour. While German banks were busy at home with the shocks and costs of reunification, their Austrian counterparts have taken advantage of their geographical ties and particularly of their historical experience in the region to establish early movers lead, and build dominant market positions in several different Central European markets.

The very same Creditanstalt was the first western bank to re-establish its presence in CE in the mid 1980s, even prior to the breakdown of the communist bloc (In fact as early as 1975 Creditanstalt opened the first representative office of a Western bank in Budapest under the communist regime). It was quickly followed by Raiffeisen ZentralBank (RZB), a co-operative banking group, which entered the Hungarian market in 1987. During the 1980s Austrian banks were only entitled to trade, finance and lend to the public sector – to companies controlled by the governments in the region. However, this initial presence has placed them in an advantageous position as the Iron Curtain came down, and indeed by the early 1990s Austrian banks' relative share in Central and Eastern European business was large and growing rapidly. Austria was re-establishing itself as the most important financial hub for the CE region.

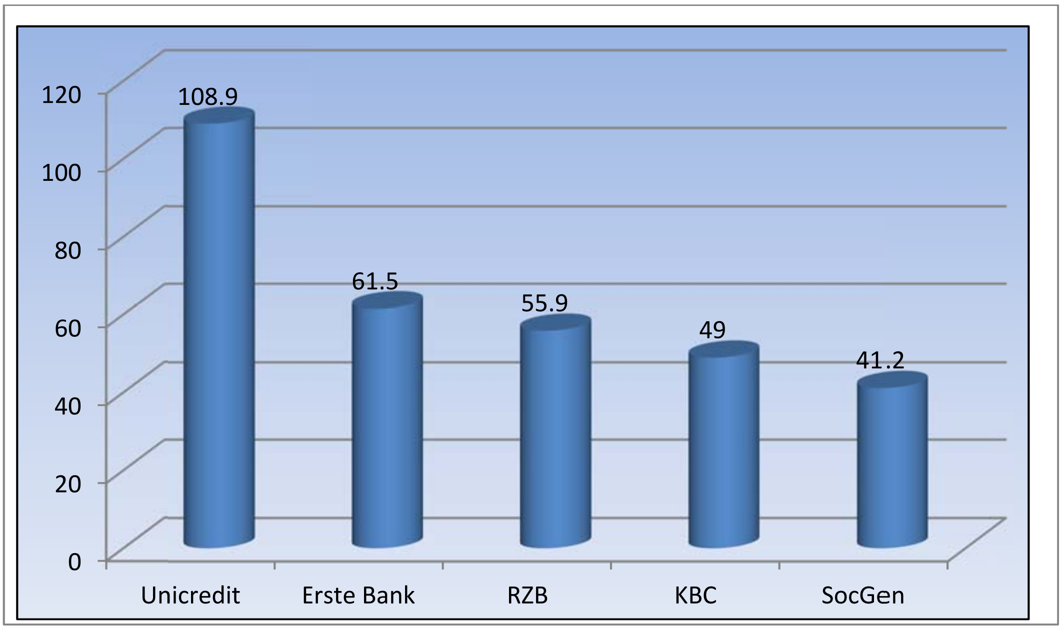
More recently, Central European financial sectors have been at the heart of the emerging trend towards pan-European banking conglomeration. In 1997 Bank Austria assumed control over Creditanstalt from the Republic of Austria to form BA-CA, only to be merged into German HVB in 2000 in a move aimed mainly at facilitating increased penetration into the growth areas of Central Europe. This merger was shortly followed in 2005 by the acquisition of the HVB group itself by Italian UniCredit, which explicitly stated the intention to consolidate its position as the biggest player in the region. Earlier this year, in a press conference held (symbolically) at the Habsburg palace in Vienna, Unicredit's CEO Alessandro Profumo unveiled the bank's strategic vision for the 2008-2011 period. The plan includes shedding approximately 9,000 jobs in Western Europe while adding 11,500 jobs and some 1,300 outlets in CE (FT, 26.06.2008). Further moves by other pan European bank-assurance groups highly active in the region such as Belgian KBC and French Société Générale are now widely expected (Ulst, 2005).

The exceptional levels of return on assets that early movers such as Austrian BA-CA and others have been able to secure since they initially entered the region is the reason behind the more recent drive by big credit institutions like UniCredit to penetrate the region. In 2005, at the eve of the Unicredit acquisition of HVB, the CE subsidiaries of BA-CA accounted for 11 percent of the total group's assets, however approximately 54 percent of BA-CA's annual profits were generated by their CE subsidiaries that year (BA-CA Annual Report, 2005).

The same holds true for all other major foreign banks in the region (see Figure 5.2 for top 5 regional players). The CE assets of Erste Bank, another Austrian bank whose forays into CE extend well into to the early 19th century, amount to 23.7 percent of the bank's total assets, however CE markets accounted for 61.4 percent of bank's net profits in 2005 (Erste Bank Annual Report, 2005). For RZB Group, the third largest foreign banking group in the region CE holdings amounted to 20 percent of the Group's assets while 40 percent of the group's net profit was generated in these markets (RZB Annual Report, 2005).

Nor was 2005 an isolated case, all major players have experienced consistent annual growth rates far in excess of the rate of growth in their home markets. Unicredit's annual CE profit growth in the period 2003-2007 averaged 15 percent. For Erste annual profit growth in CE averaged 35 percent over the same time period and for RZB annual profit growth in CE averaged 28 percent (all data sourced and calculated on the basis of the respective banks' 2003-2007 annual reports). Thus, expanding into Central Europe has proven to be an extremely successful strategy for Western European banks which have been able to generate fantastic returns on assets, well beyond the average rate of return in their already financialised home markets.

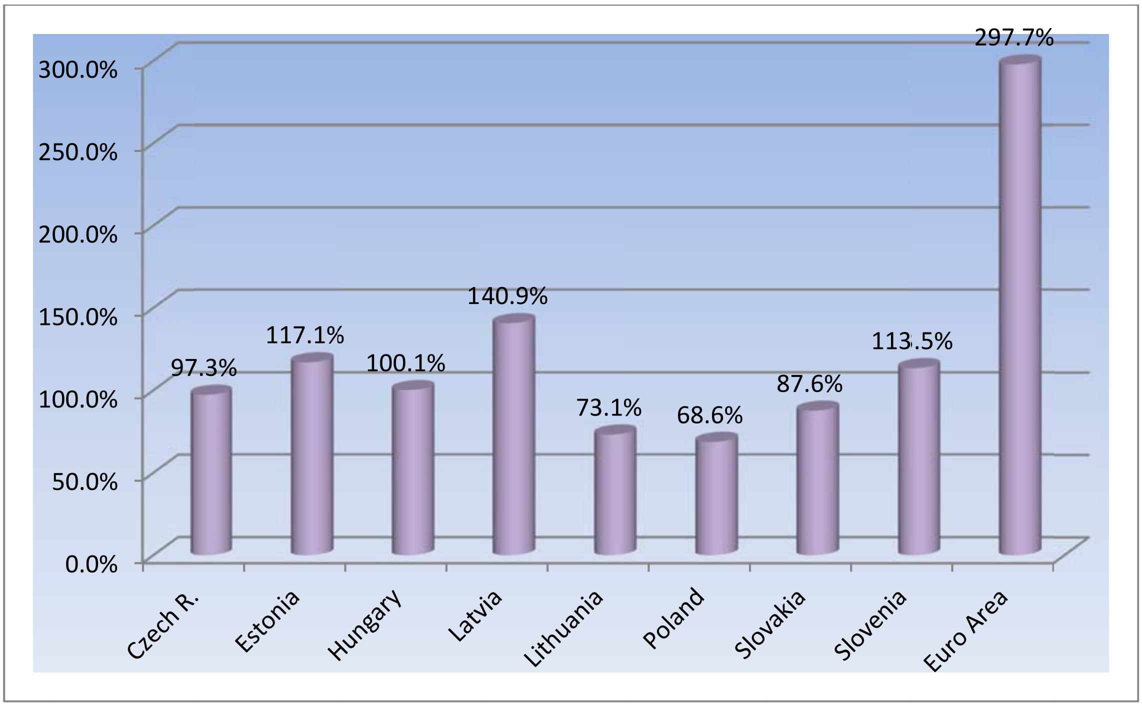
**Figure 5.2 - Top 5 International Banks in CE by Assets (€ bln)**




Source: Unicredit New Europe Research Network, July 2007:20

In the past 5 years the depth of financial sectors in the region has been growing steadily. Our three case studies are again representative of the region more broadly. In Poland banking assets in 2006 accounted for approximately 190 billion Euros, or 68.6 percent of GDP; in Hungary 94 billion Euros, or 100.1 percent; and in the Czech Republic 114 billion Euros, or 97.3 percent. Of course, this is still considerably lower than the Euro Area average of 224 percent, however, the pace of credit growth has picked up dramatically since 2003, and is significantly higher than in the Euro Area, suggesting that catching-up is likely in the medium range.

**Figure 5.3 - Total Banking Assets (% of GDP 2006)**




Source: Unicredit New Europe Research Network, July 2007:7

The overall increase in bank capitalization and assets over the past decade notwithstanding, the pace of credit growth to the non-financial private sector, (measured as the level of bank claims on the private sector as share of GDP (Beck, 1999)) has lagged considerably behind than the growth rate of total bank assets. In Hungary the ratio of private sector credit to GDP was 51.7 percent in 2005, up from 32 percent in 2000. In the Czech Republic, the ratio of private sector credit to GDP was 37.6 percent in 2005, down from 49.9 percent in 2000 due to write-downs. In Poland the ratio of private sector credit to GDP stood in 2005 on 27.8 percent, virtually unchanged from 26.6 percent in 2000 (EBRD, 2006:46). Thus despite the massive influx of foreign-owned banks, and the significant capital inflows since 2003 the average share of credit to the private sector as share of total credit for all CE countries still hovered at around 40–45 percent of GDP, unchanged from its 1993 levels (Naaborg, 2004).

To be sure, this does not mean that Western capital has not gained a dominant position over the private non-financial corporate sectors of Central European Economies. In fact well over 50% of industrial assets in the region were already under foreign control as early as the late 1990's (Poznanska, 2001). This was achieved however, mostly through Foreign Direct Investment rather than through the expansion of bank credit. What it does mean however, is that so far the influx of financial capital into these economies has only scarcely been channelled into productive investment; the kind which results in increased employment and output growth.

The advantages of a bank-based financial intermediation system over a market-based one lie ostensibly in the specificity of bank-client relations which enables banks to gain 'insider' knowledge of their borrowers and make risk assessments on the basis of an informal record of trust and reputation. Conversely, market-based financial intermediation is based on logic of homogenization, by rendering probability distributions of returns for standardized classes of financial products (Aglietta and Breton, 2001). Arguably, therefore, a bank-based financial intermediation system is more suitable for Central European economies where a large number of small and medium enterprises (SMEs) lack adequate access to equity markets and are dependent on bank credit.

However, foreign bank credit to SMEs as a share of total credit to the non-financial private sector has virtually stagnated over the past decade (Berger, 2001; Clarke, 2001; De Hass, 2006; EBRD, 2006). Whatever little increase in credit did accrue to the non-financial private sector was specifically targeted at foreign-owned enterprises and large and established domestic corporations. Foreign banks have so far 'cherry picked' only the most creditworthy clients. SMEs, on the other hand, although they form the backbone of the economy in terms of employment, are severely underrepresented in foreign-owned bank portfolios. An EBRD survey conducted in 2005 found that approximately 27 percent of small firms and 13.1 percent of medium firms in CE were unable to obtain bank loans. This compares very poorly to credit access in the EU where in Germany for example only 14.6 percent of small firms and 9.8 percent of medium firms reported difficulties in obtaining a bank loan (EBRD, 2006:47).

The developmental value of foreign-owned bank portfolios to the local non-financial private sector is thus confined to what Charles Tilly called 'development assistance to the strong' (Tilly, 1986). Of course Tilly was in fact describing the previous expansion of Western finance into Central Europe during the 19th and early 20th centuries. It seems however that the same rule applies also to the current phase of financial integration. Consequently, the plausibility of the investment optimization thesis advocated within neoclassical economics faces a serious empirical obstacle.

If Western banks have indeed shunned the private non-financial sector thus far, then this begs the question of where instead were financial funds directed? In contrast to the low and lagging growth in bank credit to the corporate sector, credit extended to households has been the main driver of credit growth in all the Central European economies. In 2005 credit to households has climbed to 38 percent of total bank loans, compared to just 23 percent in 2000 for the region as a whole (Coricelli, 2006). In the Czech Republic and Hungary Household lending as a share of total domestic lending has climbed from approximately 10 per cent in 1999 to over 30 per cent in 2005; in Poland household lending climbed from approximately 30 per cent to almost 50 per cent during the same time (Backé, 2005).

Consequently, household liabilities for the region as a whole have nearly tripled from 6.8, percent of GDP in 2000, to 17.3 percent in 2006 (Coricelli, 2006; Unicredit, 2007:14). This is of course still significantly lower than the corresponding levels of household liabilities now customary in the west; the average household liabilities across the OECD reached 80 percent of GDP in 2005, and for many EU member states is approaching or even exceeds 100 percent of GDP (OECD, 2006:136-7). Nevertheless this expansion in liabilities far outstripped the corresponding expansion in household assets, resulting in a dramatic deterioration of the household balance sheet to levels which in some cases exceed even the Euro zone average (EBRD, 2006).

The expansion of household credit in Central Europe, much as in other countries, took the forms of unsecured consumer credit and mortgage lending. Unsecured consumer credit in particular has been growing very rapidly throughout CE, again to reach levels comparable with the Euro zone average of 9 percent of GDP. Banks have undoubtedly strategically targeted such loans as they carry relative minor set up costs (hardly any information required about the borrower) while at the same time yielding a significantly high margins (EBRD, 2006:45).

Mortgage lending has also expanded significantly in all CE countries. In Hungary for example, where government subsidies were introduced in 2001, mortgage lending subsequently ballooned, (+130 percent in 2002, +70 percent in 2003) albeit from a very modest point of departure (Barisitz, 2005). Since 2003 in particular, foreign-owned banks have aggressively expanded into mortgage lending and mortgage-based debt consolidation. Similar trends have been recorded in Poland, the Czech Republic and more broadly across the region, which on average experienced an annual year-on-year growth rate in excess of 40% in mortgage lending since 2000 (Unicredit, 2007).

Thus, it is literally the homes of Central Europeans which form the primary target of Western financial expansion and its biggest potential source of profit. The reason for that lies in the comparatively high ratios of home ownership in the region; 69% of households are homeowners in Central Europe, a figure which compares favourably with the EU Area average of 70%, especially given the extreme levels of household and mortgage debt in the EU (Coricelli, 2006). In Central Europe mortgage debt is still comparatively very low, thus there is little doubt that this trend will intensify - Indeed, according to a Merrill Lynch study conducted in March 2004 the new member states are considered "seriously under-banked from a mortgage penetration perspective", and housing finance is identified as a potential growth area for years to come (Lynch, 2004). In this sense the dominancy of foreign owners in the financial system is in effect also spearheading a much wider transfer of ownership rights, through their aggressive expansion into mortgage lending.

Yet another troubling feature of credit growth in the new member states is the high (and rising) share of foreign currency-denominated loans. Whereas in Hungary and Poland foreign-denominated loans were virtually non-existent in the early 1990s, by 2004 foreign denominated credit to non-financials and households have surpassed 40 per cent in Hungary and 30 percent in Poland and is growing fast (in the Czech Republic foreign-denominated credit on the other hand is relatively limited, and has in fact decreased to approximately 10 per cent in 2004 owing to the low interest rate levels, (Backé, 2005).

Most of the loans referred to are Euro-denominated, and have typically been granted to non-financial corporations, although recently the Euro share of household loans has also been soaring as well. In extending foreign denominated loans, foreign-owned banks have effectively 'externalized' their exchange rate risks to local businesses and households who have been motivated to borrow in foreign currency by lower borrowing costs. However, unlike foreign banks, local businesses and households who predominately rely on revenues (or wage) denominated in local currency are much less able to hedge against exchange rate risks, which leaves them in a precarious position in the event of local currency depreciation (Szaparáy, 2005).

The dominance of foreign-owned banks in Central Europe has contributed not only to increased household indebtedness, but has also discouraged personal saving, thus placing a double pressure on the household balance sheet. As these banks are largely independent from the local deposit base, competition over deposit interest rates has failed to materialize. Indeed even in cases where the interest margins contracted, it was due to declining lending rates rather than rising deposit rates.

More recently, and especially as real interest levels started to decline, foreign banks began to encourage personal investment through aggressively marketing their asset management services. This is of course because asset management yields fee-based income which in Central Europe, much like elsewhere in Europe, accounts for a gradually growing share of banks incomes. Thus, the expansion of foreign banks in the retail sector is in fact heralding significant transformations in household orientation and behaviour, namely shaping expectations of income, risk (debt), and increased asset wealth in a precarious balance.

Finally, the growing inflows of foreign financial capital also present new challenges and costs for local regulators in the region. For example, in an effort to maintain relative stability vis-à-vis the Euro, local central banks in the region have accumulated significant (and growing) volumes of foreign exchange reserves. In 2004, Poland's foreign exchange reserves exceeded 2.5 times its external short-term debt (debt maturing within one year) while the Czech Republic foreign exchange reserves exceeded 4.5 time its external short-term debt (Source: World Bank statistics, data was unavailable for Hungary at the time of publishing). Thus, these economies are in a constant state of so-called 'structural liquidity surplus', and central banks in the region are forced to mop up excess liquidity from the market by selling government securities and 'sterilise' its growing reserves by purchasing foreign denominated assets.

Of course such operations are tantamount to a net export of capital by central banks in the region as the yields on their reserve holdings generally fall short of the yields they must pay on the securities they issue. These costs are further exacerbated if capital costs increase for example as a result of depreciation of the foreign currency in which reserve assets are denominated – as has been the case in the recent past due to the depreciation of the US dollar. The dollar accounts for an overwhelming majority of reserve holdings not only in Central Europe but throughout the developing world. This, in part explains why foreign banks opt to invest more in the highly liquid, relatively high yielding (and risk free) Central European government securities and consequently why the share of private and public debt is roughly in parity in Central Europe whereas in the Euro Area private debt is approximately three times higher than public debt (De Hass, 2006).

The dominance of foreign ownership in the public debt markets of CE has also proven instrumental in imposing foreign bondholder discipline over governments' fiscal policies, serving to further entrench and buttress their commitment to the neoliberal principles of economic governance. While the EU Commission has proven time and again unable or unwilling to enforce the Growth and Stability Pact targets in the old Member states, market discipline is swift and unyielding. Poland has found this out in recent years, as it has not been able to meet EU public deficit requirements and is therefore required to maintain a comparatively high nominal interest rate in order to stem financial outflows. Consequently foreign finance enjoys an even higher arbitrage income in Poland while domestic lenders face higher capital costs. Under no circumstance can this be judged as beneficial for promoting domestic economic activity and growth.

Even in Hungary and the Czech Republic, where public deficits are kept broadly within ERM requirements and nominal interest rates are comparatively low, central banks are still incapable of controlling monetary aggregates. An interest rate hike only serves to attract yet more speculative finance looking to cash in on a simple carry trade. Consequently central banks in these countries are victims of recurring speculative currency or interest attacks (Schmitz, 2004). This is virtually risk-free for investors but imposes considerable costs on central banks. The Hungarian Magyar Nemzeti in January 2003 'sterilized' foreign currency to the tune of 4bn Euros before capitulating and slashing interest rates twice in two days by a cumulative two percentage points to fend off foreign currency speculators.

## Conclusion

This chapter aimed to expose the tension that exists between the official discourse on the benefits of financial liberalisation, and the private interests of financial institutions and groups which were part of the move east. It argued that the actual motivations and strategies of Western European financial expansion were never geared towards addressing the developmental needs of Central European economies. Rather, they were inherently predatory, aimed at redressing the declining profitability of financial institutions operating in the already financialised economies of Western Europe. The dominance of foreign financiers in the region was a primary catalyst in the reorientation of state policy, corporate strategy and households' behaviour, in line with the imperatives of financially based accumulation strategies. This has led not only to an unprecedented transfer of property rights from local society to foreign investors, but also to increased indebtedness and vulnerabilities in host societies, which may well prove ultimately unsustainable in the longer run.

The chapter also makes the case for viewing the current expansion of Western European financial capital into Central Europe as an element in the broader (global) process of finance-led capitalist state restructuring. In doing so it challenges prevailing assumptions within financialisation literature about the primacy of Anglo-Saxon forms of financialisation. Clearly, in this case European institutions (both public and private) where firmly in the driving seat of finance-led restructuring. This fact is indicative of the ambiguity of the notion of European institutions as somehow different from Anglo-Saxon ones and suggests the need for a more complex approach to comparative political economy; one which adopts the global economy as its starting point and forsakes the quest for institutional convergence in favour of a more historically and spatially sensitive approach.

## Concluding Remarks

First and foremost, this thesis constitutes a rebuttal of orthodox approaches to the project of European integration. These orthodox approaches usually take an exclusively political or exclusively economic perspective. I have argued on both a theoretical and empirical basis that such a (default) separation of politics and economics does not take us far in a quest to understand the generative sociality of the European project. By deploying a critical political economy perspective I have suggested that the social exists across and through the political economic. I seek to have shown that to regard apparently economic phenomena through the tradition of economics not only upholds a reductive and exhausted disciplinary project but ensures that the generative forces behind the European project remain veiled behind a pretence to technically driven parsimony. Merely a cursory look at the dynamics and contradictions of European financialisation would suggest that rather than being outside the political, apparently economic phenomena constitutes the driving force or fulcrum of the constitution and deployment of power in the social relations of Europe.

By way of conclusion it is useful to revisit the original research questions posed to guide this project in the introductory section. The central question posed was that of how can we best understand the shifting patterns of accumulation in Europe in relation to global and regional processes of finance-led restructuring? In addressing this question the introduction also invited the reader to reflect upon issues such as where to locate the primary source or drivers of financialisation - is it the case that European political and business elites are primarily responding to imperatives arising out of trans-Atlantic geopolitical competition or does Europe play a more constitutive role in its own (and perhaps the rest of the world's) financialisation. Posed differently, we might simply have asked in which direction does the arrow of causation travel?

The conventional answer to this question is that European policy makers and bankers are operating in world not of their own making; that is that the structural power of the Washington-Wall Street nexus (otherwise known as the Dollar Wall Street Regime) is the primary determinative factor in accounting for regional and domestic instances of financialisation in Europe. However, this thesis demonstrated that the answer to this first question is far less clear cut than it might first appear and much international political literature might presuppose. In particular the diversity of micro level responses as well as Europe's aggregate growing weight and power on world markets as well as in the regulatory sphere seem at the very least to call for the qualification of this almost intuitive response shared by commentators on finance-led restructuring from various disciplinary traditions and normative persuasions.

Secondly, and related to the first question, the thesis sought to contribute to the debate regarding convergence. Is Europe marching on an inevitable path towards Anglo-American financial capitalism or, alternatively, is there an emergent, distinct and coherent European variant of financialisation, which is internally consistent and can pose a genuine challenge to Anglo-Saxon forms of financialisation? The answer to these questions is a resounding neither! The analysis of the unfolding expansion and transformation of financial practices and financial relations in Europe reveals that the financialisation of the European economic space, while subject to global and European imperatives on the one hand, is also thoroughly embedded in a pre-existing institutional and organisational contexts reaching back as far as the pre-world war I era. Thus, far from a simple convergence towards Anglo-Saxon institutional forms Europe is in fact experiencing a plurality of finance-led transformations, or financialisation experiences. While the concept of financialisation holds water as an overarching analytical tool, real financialisation is institutionally and historically conditioned and must be investigated in these terms.

At least some of the emerging constellation and institutional configurations have in fact proved remarkably 'complementary' to the exigencies of global finance and thus successful in promoting a burgeoning and globally extensive European financial sector. This is of course somewhat of a mixed blessing, as the current conjuncture of global financial turmoil and instability has, notwithstanding the crisis in the 'European periphery', left the most financialised of Europe's economies the most vulnerable, while relative laggards have tended to fare better. Meanwhile predatory expansion to the East reveals not only the institutional specificity of the financialisation of a European space, but also the limits of the current mode of expansion.

European financialisation is neither the automatic adjustment to global imperatives nor is it the outcome of an exclusive 'European' dynamic. While far from Anglo-Saxon convergence and institutional flattening, nevertheless financialisation does not leave European structures of accumulation and reproduction untouched. Equally, the crisis of financialisation is at once global and particularistic. Whether or not European financialisation will weather the storm, emerge fortified, or fold will invariably partially depend on events in other parts of the world and given Europe's position in global credit markets will arguably be at least as important for the global economy as the fortunes of the US.

This thesis has made a modest contribution to a trans-disciplinary project which seeks to reveal that in the European integration process most often considered apolitical. It has done so through a burgeoning literature in international political economy on finaicalisation and in doing so has expanded both the empirical and theoretical content of that project. It is if course only the beginning, but it represents a timely intervention and  provides a platform for further research as is to be expected of a doctoral dissertation.

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